(2) Supreme Court, U.S.
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In The

Supreme Court of the United States

RAMON E. O'NEILL

Petitioner,

v.

CONTINENTAL AIRLINES, INC.,

and

JAMES BALDRIDGE; WILLIAM MANN; LARRY DUNN, individually and as representative of a class of persons similarly situated who are referred to as LPP CLAIMANTS.

Respondent.

On Petition For A Writ of Certiorari To The United States Court OF Appeals For The Third Circuit
VOL II

PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS
APPENDIX
VOL II

Title and Description	Pages
In the Matter of the Pilot Seniority Integration Arbitration among People Express Pilot Merger Committee and Continental Pilot Merger Committee and Frontier Pilot Merger Committee and Continental Airlines, Inc ,. Ross Arbitration Award, August 13, 1991	237 – 345
United States of America Dept. of Transportation, Docket 47390	347 – 355
Public Law 85-726 Title IV Air Carrier Economic Regulation	357 – 363
Petition to National Mediation Board, Request for Arbitrators selection panel. January 29, 2002	365 – 366
Bankruptcy Code Rule 6006	367 – 368
Bankruptcy Code Rule 9014	369 – 370
Bankruptcy Court Ruling for the District of Delaware, granting some Eastern pilots the right to arbitrate. December 17, 2003	371 – 380
Bankruptcy Court Ruling for the Eastern District of Virginia. March 7, 2003.	381 – 408

Title and Description	Pages
Protective Committee v. Anderson, 390 U.S. 414 (1968)	409 – 448

In the Matter of the	)	
	)	
PILOT SENIORITY INTEGRATION ABRITRATION	)	
	)	
among	)	
	)	
PEOPLE EXPRESS PILOT MERGER COMMTTEE	)	
	)	
and	)	
	)	OPINION
CONTINENTAL PILOT MERGER COMMITTEE	)	AND
	)	AWARD
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	)	
FRONTIER PILOT MERGER COMMITTEE	)	
	)	
and	)	
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Background

This matter is before the undersigned, Jerome H. Ross, following a Federal District Court Order Compelling Arbitration of the Integration of Pilot Seniority Lists of Continental Airlines, People Express Airlines and Frontier Airlines Pursuant to the Provisions of the Labor Protection Agreement.*

On September 15, 1986, the Texas Air Corporation (Texas Air or TAC) and People Express, Inc. (PEI) entered into a merger agreement.** On the same date, TAC and PEI entered into a Labor Protection Agreement (LPA) in order "to provide assurances to the employees of the air carrier subsidiaries of PEI with regard to their seniority interests in the event of any future merger of airline operations involving any air carrier subsidiary of PEI." The LPA further provides for "fair and equitable seniority integration procedures" in the event of any such future merger. It also provides for a "final and binding decision by a Neutral Mediator"*** in the absence of agreement of the parties. The LPA also requires that a separate

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* United States District Court for the District of New Jersey, Civil Action No. 87-1155, Hon. Nicholas H. Politan, August 7, 1989.

** People Express Airlines, Inc. became the operating subsidiary of a newly formed holding company, People Express, Inc. on August 28, 1985.

*** The Court and the parties recognize that the appropriate title is Neutral Arbitrator.

procedure be conducted by the seniority integration committees for each craft or class of employees on each carrier participating in the merger. It further provides for the surviving merged carrier to participate as a party to the selection of the neutral and as a party to the proceedings.

On December 30, 1986, Texas Air, the parent corporation of Continental Airlines (the Company, Continental or CAL) formally acquired People Express Airlines, Inc. (People Express or PEX) from PEI. PEI became a wholly-owned subsidiary of Continental which remained a wholly-owned subsidiary of Texas Air.*

On March 12, 1987, Continental issued a memorandum proposing to unilaterally merge the seniority lists of the CAL pilots and the PEX pilots in the event of a consolidation of CAL and PEX operations. The list placed the top 295 PEX captains below the junior CAL captain. The remaining 162 former PEX captains were integrated into the list below the junior CAL first officer, and the remaining PEX pilots followed these former captains. The bottom of the list was composed of an estimated 1000 pilots who were to be hired in 1987 and thereafter.

The PEX pilots, represented through the People Express Pilot Merger Committee (PEX Committee), challenged the Company's list in Federal District Court. On June 15, 1987,

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* On July 11, 1989, PEI was merged with PEX and CAL was then merged with PEX. The surviving entity was renamed Continental Airlines, Inc.

the Court denied the PEX Committee's application for a preliminary injunction.

When the PEX Committee moved to enjoin the Company from implementing its lists, TAC was in the process of merging the operations of CAL and Frontier Airlines (Frontier or FAL). On June 15, 1987, Arbitrator George Nicolau issued an Opinion and Award rendering an integrated seniority list for the pilots of Continental and Frontier.

On July 10, 1987, the Company announced a revised seniority list integrating CA and FAL pilots pursuant to the

Nicolau award and integrating CAL and FAL pilots pursuant to the Nicolau award and integrating the PEX pilots as reflected under the current seniority list in the following order: 1675 CAL captains; 162 FAL captains and 295 PEX captains (integrated by date of hire, which places all FAL captains ahead of PEX captains); 299 CAL first officers (pursuant to the Nicolau award); 1262 additional CAL, FAL and PEX first officers (pursuant to the Nicolau award ratio for the first 1056 CAL and FAL pilots, and by date of hire for the remaining FAL and PEX pilots,*); 162 PEX second officers and Flight Manager Representatives (FMRs) and 508 CAL new hires. A more specific breakdown of the Company's seniority list is set forth under the section on Proposed Seniority Lists.

On October 14, 1987 the District Court ordered that the CAL pilots were a necessary party to an arbitration pursuant to the provisions of the LPA.

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* The PEX Committee claims that the first 162 of these former PEX pilots are downgraded captains.

System Bid 87-3, the first opportunity for PEX pilots to bid under the integrated flight operations, was announced on October 23, 1987.

On October 24, 1988, the Court certified the PEX Committee as the plaintiff class representative for all pilots employed by PEX as of March 12, 1987. The Court, on November 15, 1988, granted a motion for intervention filed by the Frontier Pilots Litigation Steering Committee (FPLSC) on behalf of the FAL pilots. The FAL pilots are represented in this Arbitration by the Frontier Pilot Merger Committee (FAL Committee). On April 24, 1989, the Court also certified the FPLSC as a representative of all CAL pilots, excluding PEX pilots. On the same date the Court granted the PEX Committees motion to compel arbitration.

Pursuant to the Court's Order Compelling Arbitration,

dated August 7, 1989, the undersigned Arbitrator was selected from a list provided by the American Arbitration Association. The Order provides for the participation of the PEX Committee, the FAL Committee, the Continental Pilot Merger Committee (CAL Committee) and Continental.

On February 1, 1990, at a prehearing conference, Continental filed a Motion in Limine seeking enforcement of Arbitrator Nicolau's Award of June 15, 1987, which rendered an integrated seniority list for the former FAL pilots and the CAL pilots. The motion was granted by the undersigned on February 26, 1990, thereby requiring that

the FAL pilots not argue for any change in their seniority relative to other non-PEX pilots at Continental, as determined in the award of June 15, 1987. By District Court Order dated May 14, 1990, the FAL pilots' motion to reverse this decision was denied.

Hearings before the undersigned Arbitrator were held in Washington, D.C. on the following dates in 1990: May 7-11, 15-16 and 21-24; June 4-8 and 11-15; July 9-13, 16-19 and 30; August 1-3; September 12-15, 17-21 and 30; October 1-6 and 15-19; November 5-6, 8, 10, 12, 14-15, and 27-30; and December 14-15. In 1991, hearings were held on January 7, 14 and 26; February 7, and March 2. Post hearing briefs were filed on April 2, 1991. Reply briefs were filed on April 15, 1991.* Oral argument was held on April 29, 1991. Technical support committee sessions were convened on June 14 and 27; July 11, 12 and 15 and August 7-8, 1991.

Historical Overview

This section highlights the facts and circumstances under which four airlines relevant to this integration – Continental, PEX, Frontier and New York Airlines (New York Air or NYA) – came into existence and operated.**

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* Under the briefing procedures, the FAL Committee filed its opening brief on April 15, 1991, and it incorporated its reply arguments into its oral argument on April 29, 1991.

** The relevance of NYA, which is not specified in the District Court Order, is addressed in the section on Discussion and Findings.

7

People Express

A unique chapter in the history of the domestic airline industry was written following passage of the Airline Deregulation Act of 1978 when People Express introduced a new concept in air travel.

People Express was incorporated on April 7, 1980. Its application to the Civil Aeronautics Board for permission to form a new airline listed the following objectives: (1) provide a broad new choice of flights with high frequency service; (2) keep costs low by extremely productive use of assets; (3) offer unrestricted deep discount price savings through productivity gains; (4) focus on several high density markets in the eastern United States which had not benefited from deregulation; and (5) center operations in the New York/New Jersey metropolitan area with its highly concentrated population and use the under-utilized, uncongested and highly accessible Newark International Airport as its main base.

These objectives would initially result in People Express providing frequent service to underserved cities, especially those with industrial markets, primarily in the northeast. In order to attain these objectives, management concentrated on reducing costs to a bare minimum in every aspect of the operation. All seats were sold for one deeply discounted price, which PEX termed "unbundled service" and which today is commonly known as "no frills." A difference in fares was charged for peak and

off peak hours. Fares were collected in flight, as opposed to using ticket counters and agents. Customers were charged for all in flight food and drink services and baggage checking. There were no hot galleys in the planes.

PEX's first flight service began on April 30, 1981, with three planes flying between Newark, Buffalo, Columbus (Ohio) and Norfolk. By 1982, People Express had over 1,200 employees, owned 17 aircraft and serviced 18 cities.

In addition to insuring the highly productive use of employees and the fleet, management implemented a labor relations philosophy which did not include union representation for employees. Rather, management's objective was to motivate employees to be highly efficient by making every employee a "manager" and an "owner" of the company. As such, employees performed more than one type of duty under the concept of cross utilization. For example, pilots had the job title of Flight Manager. Although their primary job was to fly planes, they were assigned duties in other functional areas (such as scheduling, air traffic, reservations or insurance) on an average of four days monthly in addition to their regular flying duties of from 80 to 86 hours each month. By 1986, many pilots were not required to work outside their flying duties. Flight attendants, with the job title of Customer Service Manager, also were cross utilized to perform duties such as fare collection on the aircraft. Employees responsible for overseeing the maintenance of aircraft carried the

Maintenance Manager job title. The Company also hired interns in six different functional areas of the operation.

Beyond the managerial concept, every new employee was required to purchase 100 shares of PEX common stock at greatly discounted prices, thus instilling the concept of ownership in all employees. In 1985, People Express employees controlled over 26 percent of the company's voting stock shares.

Employees were provided 100 percent medical and dental coverage, a profit sharing plan and other stock option bonuses and plans. The company did not offer an employee pension plan. The company's stated, although unwritten, policy was to not furlough or involuntarily downgrade employees.

In an effort to provide pilots their aircraft preferences, the company established a system which offered selection opportunities for pilots who had been hired in classes of from two to 15 employees beginning in 1981 through August 1983. The system was geared to classes in which every class member became a captain on the same date, as opposed to individual dates of hire and strict individual seniority. The system required consensus in a pilot group to resolve conflicts where all pilots could not receive their aircraft preferences. In 1983, the company implemented a new computerized bidding system, Selective Lines Individually Constructed (SLIC), which later was designed to customize flight lines based on individual

pilot requests. By 1985, a lottery system, in which seniority played no part, was implemented for bidding on flight lines.

The location of PEX's corporate offices at Newark International Airport also was consistent with the effort to operate potentially productive assets at a minimum cost. Although the airport is located in the New York City metropolitan area, it largely had been ignored. People Express inexpensively purchased a building on the airport premises to house its corporate offices. The offices were sparingly furnished and staffed. There were no secretaries, and every employee performed clerical and secretarial duties. A basis computer system was used to maintain passenger seat reservations.

The concept of a Newark hub for passenger exchange to the spokes in the People Express system proved very efficient. As the number of PEX flights increased, the

company significantly contributed to the development of a more efficient air traffic system and an improved air flow control system in the congested New York City area.

The initial success and growth of PEX resulted in net incomes of $1 million in 1982 and $10.4 million in 1983. During 1983, PEX acquired 37 B-727-200 aircraft from other airlines. It began service to London with a B-747-200 at fare prices which received wide public acceptance. The company's fleet, all previously owned, had increased to: 37 B-727-200s, five B-737-200s and one B-747-200. By the spring of 1984, PEX had 150 daily departures form Newark

-- more than any other carrier in the New York City area. In 1985, PEX and the Port Authority of New York and New Jersey (Port Authority) entered into an agreement to contruct Terminal C which PEX agreed to lease for 25 years. International service to Brussels and Montreal was added to the system. On November 22, 1985, PEI acquired Frontier, gaining a major hub in Denver, but also engaging in fierce competition there against Continental and United Airlines. In December 1985, PEI entered into an agreement to purchase Britt Airways, at the time the nation's third largest regional commuter line which served 29 mid-western cities. Within months it had completed the purchase of Provincetown-Boston Airlines (PBA). In 1986, the company joined the American Airlines Sabre reservation system, announced a frequent flyer program and offered first class airport lounges.

By January 1986, People Express was flying one million passengers a month, the fifth largest domestic airline by this measure. Its operating revenues had increased by two-thirds from 1984 to 1985. Plans were being implemented to construct Terminal C, which would become the largest airline passenger facility in the northeast.

However, the company was experiencing problems associated with its rapid growth. Overbooking, inadequate

terminal facilities in Newark and erratic departure and arrival times depressed profits in the last quarter of 1984

and the first quarter of 1985. There is also evidence that during this period employee morale was dropping from its previous high levels.

The Company experienced very substantial operating and net losses in the last quarter of 1985 and the first two quarters of 1986. With the increased decline in the company's financial condition, in June 1986 PEI retained an investment banker to seek a buyer for PEX and concurrently develop a new business plan to incorporate fundamental changes in its policies and practices – a move which had become necessary to the survival of the company. By the summer of 1986, People Express had reversed its no frills policy and had developed a plan to become a more traditional multi-class service carrier in the face of severe financial problems. After rejecting a TAC offer to buy PEX and Frontier, PEI agreed to sell Frontier to Untied in June 1986, but the transaction was never completed.

On September 15, 1986, PEI and TAC entered into a merger agreement under which TAC ultimately acquired PEX for $113.7 million, -- the figure having been lowered twice from the initial $122.1 million purchase price. PEX stockholders approved the action on December 29, 1986. TAC also purchased Frontier in the same transaction.

Continental

In 1937, a small carrier from El Paso to Pueblo, Colorado began operating under new ownership as Continental

Airlines. By 1961, Continental had added several cities in

Texas and New Mexico, as well as Wichita, Tulsa, Chicago, and Los Angeles. The airline grew steadily between 1966 and 1977, and it added several Pacific routes. From 1977 to 1982, Continental's financial situation increasingly worsened as the Company had difficulty in adapting to the effects of airline deregulation. Several merger attempts following deregulation were unsuccessful. In 1979 Continental began service in the northeast with flights to Newark from Denver and Houston. The Company's losses in 1979 through 1981 were significant.

In 1947, another carrier, Trans-Texas Airlines, began service to eight cities in Texas and later expanded to cities in Arkansas, Louisiana, Mississippi and Tennessee. In the late 1960s and early 1970s, Trans-Texas began service to Monterrey (Mexico), Denver, Los Angeles, Salt Lake City and Mexico City. In 1969 the Trans Texas name was changed to Texas International Airlines (TI). In 1972, Jet Capital Corporation, headed by Frank Lorenzo, gained voting control of TI which had posted large losses since 1968. Under Jet Capital, TI evolved into a low cost, low fare carrier and grew significantly during the 1970s and early 1980s. During 1978 and 1979, TI launched an unsuccessful effort to acquire National Airlines, but realized a large profit through the sale of the National stock it had acquired.

In 1980, TI created a holding company, Texas Air Corporation. Texas Air, in turn formed New York Air,

which it operated as a separate, non-union subsidiary offering a simple low fare structure and high frequency service.

In March 1982, Texas Air assumed control of Continental, which was deep in financial difficulty, and partially guaranteed Continental's debt. Texas Air itself, however, was incurring operating losses at the time of the merger with Continental.

On October 31, 1982, Continental and TI merged as

Continental to become the sixth largest carrier in domestic revenue and passenger miles. Texas Air, the holding company which had been created in 1980, had two subsidiaries, Continental Airline Corporation and NYA. Continental continued to operate at a loss in 1982.

By summer 1983, Continental had suffered heavy losses which TAC agreed to partially guarantee. Relations between Continental and its unions were poor, and the International Association of Machinists struck the Company. On September 2, 1983, Continental suspended operations and filed for bankruptcy. It resumed operations under Chapter 11 on September 27, 1983, with a two-thirds reduction in fleet, staff and number of cities it serviced. Moreover, it unilaterally implemented "emergency work rules" which cut wages and increased productivity, notwithstanding an existing collective bargaining agreement with its pilot union. In protest against the pay cuts, loss of seniority rights and other work rules, Continental pilots initiated a strike

which remained in effect for almost two years. In October 1985, Continental and the Air Line Pilots Association (ALPA) negotiated a strike settlement which provided the pilots a choice from the following three options: (1) waive all claims against the Company and return to work as vacancies occurred; (2) receive severance pay in lieu of returning to work; and (3) not waive claims against the Company and return to work after all option (1) pilots have returned or be removed from the hiring lists on December 31, 1988.

While operating in bankruptcy, Continental began to deeply reduce its fares. The move was very successful in attracting passengers. During 1984, with financial backing from Texas Air, Continental began to rebuild its system by adding cities and increasing flights. In August 1985, Texas Air launched a new carrier, Continental West Airlines, as a

full-service, low fare operation. Continental, still operating under bankruptcy rules, attempted to acquire 30 jetliners, but initially was able to sublease only four, with additional leasing arrangements contingent on court review of its financial and operating performance during the first half of 1985.

After February 1986, when Texas Air had bid successfully for Eastern Airlines, several other airline mergers were announced as companies were restructuring in an effort to attain "supercarrier" status in order to successfully compete in the market place. In acquiring Eastern,

Texas Air was required to sell the shuttle service operated by NYA.

On September 2, 1986, Continental emerged from bankruptcy with two main hubs at Houston and Denver, 40 percent larger than in 1983 when it had entered bankruptcy, and with plans to add to its fleet, as well as with a long term debt service obligation of almost $2 billion.

With the acquisitions of People Express and Frontier on September 15, 1986, Continental strengthened its presence in the east coast markets, gained major hubs in Newark and Denver, and achieved the critical mass required to attain supercarrier status. On February 1, 1987, PEX and NYA operations were merged into Continental.

Frontier

Monarch Airlines began serving Denver, Salt Lake City and Albuquerque in 1946. A bankruptcy was averted in 1947 when the airline was sold. In 1949, Monarch acquired Arizona Airlines and Challenger Airlines. The three carriers combined to form Frontier Airlines. By 1956, Frontier served 68 cities and had 700 employees. Controlling interest in Frontier was sold in 1958 for $750,000 and again in 1964

for $2.5 million when RKO General, Inc. (a subsidiary of General Tire Co. of Akron, Ohio, later to become GenCorp) bought 56 percent of Frontier for $6.5 million. RKO General remained the majority stockholder until the airline was sold to PEI in 1985.

17

During the 1960s, Frontier gained a reputation as an on time airline providing a high standard of service to many small and remote locations. In 1967, Frontier merged with Central Airlines. By the end of the 1970s, 53 of Frontier's 89 cities were government-subsidized. In 1979, Frontier registered record profits and began preparing for operation under deregulation by terminating service to several cities and adding others. In 1981, Frontier again set new earnings records and began serving larger cities such as Los Angeles, Seattle, Atlanta and Detroit. In 1982, Frontier became a subsidiary of Frontier Holdings, Inc. In 1983, as a result of a fare war in Denver between United, Continental and Frontier, Frontier Holdings posted a $13.8 million loss – its first in 12 years. The Denver battle continued into 1984 during which Frontier employees agreed to heavy wage concessions and the airline posted a $31 million loss. In 1984, Frontier Horizon, a non-union carrier subsidiary of Frontier Holdings, began service out of Denver.

The situation worsened in 1985. Attempts at an employee buyout plan failed as Texas Air tendered a share offer in excess of the employee offer. However, PEI outbid Texas Air and purchased Frontier in October 1985, using $200 million in cash from Frontier to fund the $309 million purchase. In a concurrent transaction, PEI and Frontier and its unions entered into an agreement which provided in part that: no further wage reductions or

18

furloughs would be implemented; Frontier would not be

merged with Continental, nor would it be sold to TAC/CAL; PEI would not sell Frontier assets in excess of $25 million; and PEI would provide sufficient working capitol to operate Frontier as a viable entity.

Frontier's losses increased under a new marketing strategy of deeply discounted fares and no frills service led by a new president selected by PEX Chairman Donald Burr. By May 1986, the marketing strategy was reversed as premium coach service was begun.

Following a $58.9 million loss in the first half of 1986, PEI, after having rejected a prior TAC offer to buy PEX and Frontier, announced tentative agreement to sell Frontier to United for $146 million. The purchase required United and its pilots to reach agreement on the wages and other terms under which the Frontier pilots would be employed at United. Their discussions continued until late August 1986. Although agreement was not reached, PEI received approximately $47 million from United for the sale of various Frontier assets.

On August 24, 1986 Frontier ceased operations, and it filed for bankruptcy on August 28, 1986.

On September 15, 1986, Texas Air agreed to purchase Frontier for $176 million in conjunction with the People Express acquisition.

19

New York Air

In December 1980, New York Air began operations as a subsidiary of Texas Air which owned 67 percent of NYA's common stock. NYA had leased six DC-9s from Texas Air to begin service between New York and Washington, D.C., Baltimore, Buffalo, Cincinnati, Cleveland, Detroit and Louisville, and between Boston and Washington, D.C. and Baltimore, and between Baltimore and Orlando. Texas Air initially provided NYA with $10 million of equity capital and agreed to guarantee a $15 million line of credit.

The NYA and PEX operating plans were similar in that both offered low fare, high frequency service based on high productivity, efficiency and simplicity of operations.

New York Air incurred an $11.6 million loss during its first year in operation. In January 1982, Texas Air purchased an additional $8 million of NYA convertible preferred stock. NYA's net operating loss for 1982 was $23 million. During 1983, NYA's fleet composition changed under leasing and sub-leasing arrangements with Texas Air, resulting in eight MD-80s moving from NYA to Continental. Moreover, NYA used two of Continental's Washington National Airport slots during 1983. Although NYA showed a $4.5 million net operating profit in 1983, it experienced a $6.8 million net operating loss in 1984. In 1985, Texas Air acquired the remaining shares of NYA's common stock. NYA's 1985 net loss was $2.4 million.

In order to acquire Eastern in 1986, Texas Air was required to sell the Eastern shuttle service to Pan Am. The agreement between Texas Air and Pan Am was signed on September 12, 1986. The NYA shuttle operation was moved to Newark after Texas Air sold Pan Am 19 NYA arrival and departure slots at Washington National, 56 NYA arrival and departure slots at La Guardia and access to two NYA gates at Logan for $62.8 million. NYA showed a net profit of $36 million in 1986.

NYA was merged into Continental in February 1987. During its brief history, NYA started and ceased service from Boston, New York or Washington, D.C. to 82 cities.

TAC-PEI Merger Agreement

The TAC-PEI merger agreement, dated September 15, 1986, was one of the most complicated acquisitions in airline history. It set forth numerous terms and conditions which required PEI to use its best efforts to preserve People

Express operations and to refrain from attempting to sell the operation to another party. The agreement further required PEI to represent that PEX was a failing company for purposes related to merger and anti-trust considerations. The agreement established several conditions precedent to effecting the merger, such as: (1) approval by PEI stockholders; (2) DOT approval of the merger; (3) agreement of the Frontier unions; (4) acquisition by TAC of Frontier assets through bankruptcy court

approval; (5) PEI remaining out of bankruptcy and continuing to pay its debts as they became due; (6) PEI not ceasing or suspending any significant portion of its operations or business; (7) PEI using its best efforts to obtain waivers of default from its banks, and (8) TAC receiving waivers of claims of Frontier pilots arising out of the October 1985 agreement with PEI. It also required PEI to refrain from soliciting any other offers of purchase. As part of the agreement, PEI granted TAC an option to purchase a new issue of People Express convertible preferred stock, representing approximately 30 percent of the PEX voting power, exercisable while the merger agreement was in effect upon the occurrence of certain events.

The record further reflects that the merger agreement was renegotiated by the parties twice after September 15, 1986. In October 1986, TAC initiated discussions to renegotiate the terms of the agreement following PEX's heavy losses in September. As a result of the discussions, the amount paid by TAC was reduced. The PEX board of directors approved the renegotiated terms on November 2, 1986. Later in November, TAC again renegotiated lower terms which were approved by the PEX board on November 28, 1986.

Events Following the Merger Agreement

Certain events involving seniority integrations at

Continental, which bear on the present proceedings,

occurred after the September 15, 1986 merger agreement.

On October 2, 1986, the Job Protection Agreement (JPA), under which the FAL-CAL seniority integration was conducted, was signed. In November 1986, Continental hired the former Frontier pilots and merged CAL-FAL flight operations after Texas Air, through NYA, took delivery of Frontier's 44 aircraft and airport properties.

Between October 1986 and January 1987, the PEX pilots formed a research committee to prepare for their seniority integration arbitration with CAL pilots. The committee held its first meeting in December 1986. It retained counsel in early 1987.

A CAL-NYA seniority integration award was issued by Arbitrator Richard I. Bloch on December 18, 1986. It was implemented on January 27, 1987 for System Bid 87-1 which was open to CAL and NYA pilots, but not to PEX and FAL pilots.

The CAL-FAL seniority integration arbitration was held in early 1987, and following the submission of post-hearing briefs, the award issue on June 15, 1987.

On February 1, 1987, the Company began marketing CAL, PEX and NYA as a single integrated airline. The management of People Express operations, marketing and administration functions was assumed by Continental.

Between January and March 1987, Continental and the PEX Committee unsuccessfully attempted to reach agreement on a seniority integration procedure. On March 10, 1987,

the Company informed the PEX Committee that it would unilaterally created a seniority list containing the CAL and PEX pilots to be used in the event the operations were

merged. The list was announced on March 12, 1987.

On July 10, 1987, the Company issued another seniority list which included the FAL pilots. System Bids 87-2 A and B – an alternative arrangement with one option providing for PEX pilot participation in the event CAL and PEX operations were merged – were never implemented.

On October 23, 1987, System Bid 87-3 was issued. For the first time, a system bid was open to all CAL pilots (including former FAL and NYA pilots) and former PEX pilots. The bid was awarded on December 11, 1987 and effective on July 1, 1988, when all CAL and PEX pilots first were fully staffed together.

PEX's Financial Condition

In April 1986, People Express had begun to implement portions of a new marketing strategy in an effort to stem heavy first quarter 1986 losses. In June 1986, PEX announced that it was downsizing its operations due to an excess of capacity, and all or part of the airline was for sale. Although its boarding rate exceeded 2.1 million passengers in August 1986 (30.7 percent more than August 1985 and a new monthly record), the company's heavy losses continued in the second quarter. PEX's net loss for the first six months of 1986 was nearly $80 million. The

Company incurred modest net losses in July and August 1986.

A preliminary business plan for PEX, dated August 7, 1986, states that although "PEX's cost structure is a very powerful competitive advantage, . . . given the revenue driven nature of the airline business, [PEX] must embark on a strategy to enhance its revenues." In addition to the new marketing strategy aimed at raising revenues, the company negotiated an 18-month lease to Pan Am of eight B-727-200s, which were excess to its current needs, for $8.4

million. It was also considering several possibilities for three of its B-747s, including their sale or lease to another carrier. The business plan projected an increase in operating income of $40.7 million following its full implementation in the second year, after losses during the first and third quarters of the plan's implementation. The plan required a 25 percent reduction in daily departures, a 14 percent reduction in block hours, and a break even load factor (BELF) of 70 percent. In addition, the company's fleet would be reduced from 79 to 69 aircraft (two less B-747s and eight less B-727s) which would undergo extensive modification in order to provide multiclass service. Fifty eight of the 69 aircraft would be in service at any given point in time.

A "preliminary draft" dated "September__, 1986" by Morgan Stanley & Co., Inc., the investment banker retained by the PEX Board of Directors to review the conditions of

the TAC-PEI merger prior to September 15, 1986, states in part: ". . . without the prompt infusion of a significant amount of cash from asset sales or sales of new equity, there is grave doubt that the Company will be able to meet its ongoing financial obligations in the near future." It further states: "Other than as described herein, no financially responsible company as of this date has made a credible proposal for the acquisition of PEI, and no other such proposal appears immediately forthcoming."

The TAC-PEI merger agreement and plan, dated September 15, 1986, required that PEX "shall affirmatively state and use its best efforts to demonstrate orally and in writing that it is a failing company both for purposes of any submission to [the U.S. Department of Transportation] and for purposes of any filing with or notification to any federal antitrust authority . . ..."

During the third quarter of 1986, which ended on September 30, two weeks after the merger announcement,

PEX recorded an operating loss of nearly $24 million and a net loss of $40 million. The company's losses for the first nine months of 1986 were $120 million. On September 30, 1986, People Express had a working capital deficit of $147.8 million, as compared to $10.7 million on December 31, 1985. Its debt service requirements as of September 30, 1986 were $34.5 million through December 31, 1986, of which $15.6 million had been paid through November 14, 1986. An Internal Revenue Service assessment of $11.5

million against the company also was outstanding.

On October 15, 1986, the U.S. Department of Transportation (DOT) issued a Show Cause Order concerning the acquisition of PEX by TAC. Although the DOT declined to render findings as to whether PEX was a failing company because, it noted, such a determination was relevant only if it had found the acquisition to be anticompetitive, the order observed: " . . . the applicants themselves have made public facts suggesting that [PEX] will not survive without the acquisition. People Express' financial difficulties have become widely-known as a result." The order further stated: ". . . the imposition of LPPs is likely to cause Texas Air's withdrawal from the transaction and thus the bankruptcy of People Express."

The DOT's Final Order in the above transaction, dated October 24, 1986, noted:

> . . . The record amply demonstrates that prompt approval of the acquisition is necessary for [PEX's] survival. People Express in fact would have run out of cash already but for the financial assistance provided by Texas Air under the merger agreement, and that agreement does not require Texas Air to provide any additional assistance after this month. Without the last payment by Texas Air at the end of this month, People Express would have little or no cash left,

> and it appears unable to obtain cash from any other source. App. October 9, 1986 letter at 3. Its cash shortfall from operations appears to exceed $500,000 each day, a rate of losses which will rapidly exhaust the last cash advance due from Texas Air.

27

The order also stated: " . . . Given People Express' critical financial condition, it is unlikely that the carrier could continue to operate at its present scale if it remained independent."

The minutes of a special PEX board of directors meeting on September 14, 1986, state in part:

> At this point in the meeting, Mr. Burr asked Mr. Norris to review with the Board the Company's current cash position and projected cash flows through the end of the year. Mr. de Leeuw then reviewed with the Board the status of the Company's accounts payable. Mr. de Leeuw stated that there could be no assurance that vendors or other creditors of the Company would continue indefinitely to allow the Company to extend payment periods. Messrs. Norris and de Leeuw reported to the Board that they had developed day-to-day and week-to-week cash flow forecasts based upon anticipated revenues, scheduled lease and debt payments and anticipated operating expenditures. Messrs. Norris and de Leeuw reported that, without the prompt substantial infusion of a significant amount of cash, management's projections indicated that the Company would be in a negative cash position by mid-October. Mr. Norris and Mr. de Leeuw reviewed the status of the Company's ongoing efforts to raise cash by

disposing of aircraft. Messrs. Norris and de Leeuw reported to the Board that it did not appear that a partial liquidation of the Company's aircraft and other assets represented an alternative method of both resolving the Company's cash flow deficit and placing its operations on a profitable basis. The fact that the Company's aircraft were already heavily financed and had little remaining equity value and that the market for used aircraft, particularly Boeing 747's, was very weak made it very remote that the Company could raise enough to continue operations as an independent entity even under the protection of Chapter 11 of the Bankruptcy Code. The Board also considered the revenue impact that might result from a public admission of the Company's status as a failing company. Mr. Fiedorek then reported to the Board that the

cash flow forecasts presented by Messrs. Norris and de Leeuw were corroborated by month-to-month cash flow projections which had been developed by Morgan Stanley. Mr. Fiedorek also reported that representatives of the Palmieri Company ("TPC") had concluded, on a preliminary basis, that management's cash flow analysis was essentially correct.

* * *

Mr. Norris then reviewed the Company's projected cash flows in the context of a bankruptcy proceeding. Mr. Norris reported that management had concluded that, in a bankruptcy proceeding, the Company might be

able to have a modest positive cash position at year end, but that such analysis did not consider any negative impact on revenues resulting from a bankruptcy filing. It was noted that the Company's cash position was so critical that any adverse revenue impact of a bankruptcy proceeding would have a material adverse effect on the Company's cash position and its viability. It was the conclusion of management that a bankruptcy liquidation would result in only a 50% realization for unsecured creditors and no residual equity for the holders of the Company's Common Stock and Class B Common Stock. In addition, it was management's view that the Company did not have a realistic possibility of reorganizing in bankruptcy for various reasons, including the uncertainty as to the ability of People Express Airlines to retain the rights to Terminal C in the event of a bankruptcy.

The record also contains a document dated September 17, 1986 and titled, Transcript of Discussion with People Express Board of Directors. The discussion reflects that a financial consulting firm, The Palmieri Company, was commissioned by PEX to undertake an intensive review of the company's financial position. The group, which was composed of experienced consultants, spent two and a half days examining: (1) the company's "status quo cash flow"; (2) the underlying assumptions in the company's forecasts; (3) adjustment in

the forecasts for the effects of a bankruptcy proceeding; (4) other potential cash sources and risk issues, and potential responses to routing and fleet deployment and pricing and labor issues; and (5) whether the company could hope to

exist as a viable business. The group found that "the cash flow could not be more critical" and the "near term cash crises . . . leaves very little room to maneuver outside of a [bankruptcy] proceeding or outside of a sale such as the one that has been negotiated." The group further found that "it would be difficult to find anyone who . . . would be willing to testify to a judge that there was over the period of six months to a year an opportunity to make a business out of this airline." The group concluded: Therefore, we think that it is more than likely based on the observations of our study, that a Chapter 11 proceeding does not present an alternative to the company and would likely lead to a liquidation in a relatively short period of time."

The record is unclear concerning PEX's assets at the time of the merger. A letter of October 9, 1986 from counsel for TAC and PEX to a DOT official stated:

> People Express also has no unencumbered assets that have any significant equity that would provide an opportunity for raising additional capital. The majority of People Express' aircraft fleet (53 aircraft) are covered under publicly-held secured equipment trust certificates the trust indenture which contains a provision which prohibits People Express

> from creating any additional liens on those secured aircraft. The remaining 26 aircraft are covered under capitalized leases or operating leases which would provide no financing opportunities since People Express does not own the assets.

The record also reflects that the company held about $60 million in spare parts, $35 million in slots and gates, an undetermined amount of collateralized equity in its aircraft

and international routes, including Newark to London.

On September 15 and October 3, 1986, TAC respectively infused $10 million and $20 million into PEX. By December 18, 1986 TAC had provided PEX $107 million through 11 separate cash infusions. PEX's net loss for 1986 was $198.5 million. (200 million from Eastern)

Compensation Comparisons

This section reviews the major items in the compensation packages at People Express and Continental in September 1986.

PEX employees received 100 percent paid medical and dental insurance through a self insured company plan. Disability insurance was fully paid for the first six months of incapacitation, with 50 percent of base salary up to $3,000 per month thereafter, also through a self insured company plan. Stock ownership in the company was available at significantly discounted prices. Employees also participated in the Ownership Income Plan based on the number of shares they held. After 1984, the profit sharing plan

for pilots changed to a return on revenue plan. Although the company did not offer a retirement plan, employees could participate in a 401(k) stock purchase plan. A $50,000 death benefit policy for each pilot was provided by the company. Vacation was accrued at the rate of 14 days per year on completion of one year of employment. Employees received unlimited paid sick leave days and seven paid holidays each year. They also received credit for training days. The company's unwritten no-furlough policy was to provide employees with a "job for life." Employees received unlimited flight pass privileges.

Continental's medical and dental plans contained deductibles and provisions for co-insurance. The Company today offers employees the opportunity to enroll in a dental

plan with no deductible. Although no paid disability insurance was offered in 1986, the Company today pays one-half of the cost for this item, and it offers a long term disability plan. In 1988, Continental established a retirement plan which is a 100 percent company funded, defined benefit plan. It also offers a 401(k) plan and matches 25 percent of an employee's contribution up to three percent of salary. In addition, the Company provides a flex-benefit program which entitles employees to contribute up to two percent of salary to purchase certain benefits and up to another two percent of salary in lieu of one week of vacation. The life insurance benefit is equivalent to a pilot's annual base salary. The profit sharing

plan provides for payment to employees for the years in which the Company realizes a net profit. Continental, at the time of the merger, provided for pilots to accrue sick leave on a monthly basis. Today, the Company provides up to five months of paid sick leave. Vacation is accrued at the rate of seven days per year after one year of service. There are no paid holidays, and no credit is given for training days. After six months of service, an employee has unlimited flight passes.

The PEX salary structure for pilots after four years of service, effective August 1, 1985, was as follows: Captain/Team Manager - $75,500; Captain - $68,300; First Officer/Team Manager - $60,500; First Officer/Team Leader $54,500; First Officer - $48,500; and Second Officer - $48,500. Captain's pay for new hires through four years of service successively was: $42,000, $48,000, $53,800 and $60,500 (with overrides for team manager duties ranging from $4,000 in the second year to $7,200 in the fifth year of service). First officers' pay ranged from $22,000 for a new hire to $41,800 for four years of service (with $12,000 overrides for team managers and $6,000 overrides for team leaders). Second officers' pay ranged from $12,000 for a

new hire to $41,800 for four years of service (with the same $12,000 and $6,000 overrides paid to first officers in leadership positions). An incentive program based on the sharing of revenues from in-flight commissary sales, with the potential for a $6,000 average

annual incentive payout, was implemented in 1986. A question remains regarding whether a $12,000 pay cut was effective in November 1986, or prior, for captains not working in a support function.

Continental salaries for captains ranged from $48,750 for the first four years of service to $50,000 for five to ten years of service, and amounts ranging from $52,500 $64,000 for from ten to 30 or more years of service. First officer pay for a new hire increased from $15,000 to $24,000 after six months and from $33,000 in the second year incrementally to a maximum of $40,000 in the sixth year of service. Second officers were paid the same rates as first officers during the first year and earned from $29,000 in the second year to a maximum of $35,000 in the sixth year. In addition to these salary scales, all pilots were paid a portion of the savings realized from fuel efficient flying practices which amounted to 27 percent of their pay. Over 90 percent of all pilots received a training incentive of $3,000, paid to all employees who do not change equipment on a bid. Pilots also received additional pay for flying in excess of the 83 hour per month guarantee.

PEX Facilities

PEX's facilities may be divided into three components: (1) Terminal C at Newark International Airport; (2) other structures in and around Newark International Airport and (3) outstations and slots.

Newark International experienced phenomenal growth in the 1980s. It now handles about 40 percent of the total revenue passenger traffic in the three major airports serving the greater New York City area. Seventeen million people reside within 50 miles of Newark International. An expansion of the airport's capacity is estimated to double its passenger traffic to 50 million by the year 2000.

In 1984, People Express and the Port Authority agreed to reconstruct Terminal C which had been built in 1971. On January 11, 1985, the parties entered into a contract for the construction and lease of the facility. PEX received the rights to 41 gates; Eastern, nine gates; U.S. Air, seven; NYA, five, and Delta, four. The International facility in Terminal C was not restricted to PEX use. Although PEX contributed no money toward the construction of Terminal C, it worked on the design and construction schedule of the 860,000 square foot facility. The Port Authority agreed to fund the construction project up to a cost of $150 million, and up to $175 million on subsequent approval. The opening date of the facility, which originally was scheduled for February 1986, was extended to the summer of 1987 due to construction delays. The Port Authority took control of the construction project from PEX. In September 1986, the construction schedule was more than 50 percent completed, with the foundations laid, major structural steel in place, exterior skin

affixed, ramps largely finished and some interior mechanical work accomplished. PEX's rental payments on Terminal C were to commence on January 1, 1987. PEX's 25 year lease was converted to a month-to-month tenancy on September 30, 1986, when it failed to meet certain financial conditions under the agreement with the Port Authority. On August 15, 1987, with the Port Authority's consent, PEX assigned its rights under the lease to Texas Air. The Port Authority and Texas Air reached agreement on a new 25-year lease, an

increase to $225 million of Port Authority funding and a reduction in the rental to be paid by Texas Air. When Continental assumed control of the construction project, it was 84 percent complete at a cost of $165 million. Continental undertook extensive redesign of the facility which opened on May 22, 1988. Construction work on Terminal C continued into 1990. From August 15, 1987, when $152 million had been spent on the facility, the Port Authority has funded increases to a total cost of $232 million. Continental ultimately will reimburse the Port Authority through rental payments. Continental additionally has contributed $56 million to the project. The total cost of Terminal C as of April 1990 was $291 million.

PEX released several other facilities in and around Newark International, including the North Terminal which housed 23 PEX gates, the North Terminal Annex, the hangar 55 complex and the cargo building which houses other tenants. Offsite facilities included the Haynes Avenue

building, the International Plaza building and a simulator facility 30 miles from Newark International in Totowa, New Jersey. Continental assumed the leases on all of these properties.

PEX held leases on more than two dozen outstations at various airports which included terminal space, landing rights, gates and slots. It also owned or leased a variety of ground equipment at these stations. PEX held 200 slots at high density controlled airports, most of which were commuter slots.

Flight Manager Representatives

In 1984, PEX began investigating other sources for the recruitment of pilots. The approach selected in November 1985 involved the hiring of pilots who could qualify with a minimum number of flight hours, and who would be trained

"from the ground up" using simulators for instruction as opposed to aircraft. Candidates for this Flight Manager Representative (FMR) program were selected from young aggressive recent aviation school graduates who would require a longer period to upgrade from second officer through first officer to captain positions. These candidates were ranked in the top third of their class with a minimum 3.0 grade point average, and a recommendation from the dean of their school. They held a commercial instrument multi-engine rating and had completed the flight engineer dispatcher written examinations.

37

The first employees to qualify for the program were ten in-house PEX employees who met the majority of these qualifications. In August 1985, they were placed in a Flight Manager Development (FMD) program developed by the company. The program was flexible, and it was changed as the company itself was changing in 1985. Additional new hires for the same program, known as FMRs, were recruited with the aim of quickly attaining captain positions. They were generally about 35 years old. Recruiting efforts for succeeding FMR classes focused on younger people in an effort to avoid future problems arising out of mass retirements. These FMRs were brought on board in a type of probationary status in a training program from which they would graduate as second officers qualified on the B-727. Following the requisite simulator training, they would become first officers. After PEX acquired Britt, FMRs were trained on commuter aircraft. The time frames for FMR progression to the first officer position are in dispute between the parties. The starting salary for FMRs was $12,000, and they were eligible for the incentive program with a potential payout of $6,000.

PEX hired approximately 180 FMRs and immediately placed them on the pilot seniority list. Approximately 30 resigned before completing the program. Of those 30, 17

were hired by other airlines. Twenty nine FMRs who had over 1,500 flight hours attempted, and all successfully completed, an optional "up or out" program at

Continental under which they became qualified as first officers prior to completing the Company's training schedule at its commuter operation for the remaining FMRs. Of the remaining FMRs at Continental in June 1990, 112 were qualified to fly as first officers and the balance were second officers.

Fleets

On September 30, 1986, CAL operated 149 aircraft with 116 on order or option (58 on order and an additional 58 on option.* CAL's fleet consisted of: 50-B-727-200s, 24 B-737-300s, 16 DC-9-30s, 14 B-727-100s, 14 DC-9-80s, 11 DC-9-10s, eight DC-10-10s, six DC-10-30s and six A-300s. Between September 4 and 15, 1986, PEX had leased seven B-727s to Pan Am (and an additional B-727 on October 1, 1986) for use on its shuttle. Moreover, under the September 15, 1986 merger agreement, PEX had agreed to lease back from NYA six B-727-200s which ultimately passed to CAL through NYA. The record reflects that both PEX and CAL pilots flew these aircraft in December 1986.

By December 31, 1986, CAL was operating 244 aircraft with 104 on order or option. On December 30, 1986, PEX had taken delivery of an additional B-747

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* Arbitrator Nicolau had identified 104 CAL aircraft on order or option as of September 12, 1986. The difference between 112 and 104, 12 B-727s, was placed on option from PEX to TAC pursuant to the September 15, 1986 merger agreement in return for the cash payments of $49.5 million to PEX.

which was paid for by TAC and flown by both PEX and CAL pilots in 1987.

In a March 12, 1987 announcement to pilots, CAL management stated that PEX pilots would receive credit for 66 aircraft – 22 B-737s, 36 B-727s and eight B-747s (one of which was paid for by TAC and did not fly for PEX in 1986).

On September 15, 1986, FAL's fleet contained 25 B-737-200s and 16 DC-9-80s, for a total of 41 two-pilot narrow-body aircraft.

On September 15, 1986, NYA's fleet contained eight B-737-300s, 20 DC-9-30s and six DC-9-80s, totaling 34 two-pilot narrow body aircraft.

The Company's Staffing Analysis

The Company's staffing determination for PEX pilots is based on its analysis, in late February or early March 1987, of PEX operations using Continental's pilot utilization. The monthly block hours assigned to PEX operated aircraft were: 11,408 for the B-727s, 5,332 for the B-737s and 1,829 for the B-747s. These figures were based on the maximum number of hours on a daily basis projected in 1987 for the PEX aircraft in operation at Continental. The monthly block hours per pilot used in the staffing analysis was: captains, 64.6; first officers, 64.25 and second officers, 66.52. These figures yielded a total of 289 captains (177 for the B-727s, 83 for the B-737s

and 29 for B-747s). In order to accommodate a PEX management request to include a specific PEX pilot who had performed significant non-revenue flying duties, six additional captains were added to reach the 295 figures. The number of first officers was calculated at 290 (178 for the B-727s, 83 for the B-737s and 29 for the B-747s). The number of second officers was 200 (172 for the B-727s and 28 for

the B-747s). The total number of pilots required under the Company's staffing analysis was 785.

Overview of the Proposed Seniority Lists

The Company

The Company's proposal, as reflected in Bid 87-3, establishes the following seniority list: numbers one through 1,675 were awarded to CAL (including NYA) captains; numbers 1,676 to 2,119 were awarded to FAL and PEX captains by date of hire; numbers 2,120 to 2,418 were awarded to CAL first officers pursuant to the Nicolau Award under which 299 pilots (285 CAL first officers and 15 former NYA pilots) were placed for captain expectancies based on CAL's order and option aircraft; numbers 2,419 to 3,680 were awarded to CAL, FAL and PEX first officers, of which the first 756 pilots (579 CAL and 177 FAL) were integrated by ratio under the Nicolau Award and the remaining FAL and PEX pilots were integrated by date of hire; numbers 3,681 to 3,842 were awarded to the PEX FMRs as second officer positions; numbers below 3,842

were awarded to CAL pilots hired in February 1987 and thereafter.

Under the Company's proposal, as of September 1, 1990,* the pilot seniority list was as follows: numbers one to 1450 were held by CAL pilots; numbers 1451 to 1575 were held by FAL pilots; numbers 1576 to 1794 were held by PEX pilots; numbers 1795 to 2084 were held by CAL pilots; numbers 2085 to 2725 were held in a ratio of CAL and FAL pilots; numbers 2726 to 3019 were held by PEX pilots (except for four numbers held by FAL pilots); numbers 3020 to 3070 were held by FAL pilots; numbers 3071 to 3210 were held by PEX pilots (FMRs). The remaining numbers were held by CAL pilots or reserved for CAL

commuter pilots.

PEX Committee

The PEX Committee's proposal is based on the concept that each pilot group (not including FAL which was not operating on September 15, 1986) is entitled to the jobs it brought to the merged carrier on September 15, 1986. The job entitlements, as viewed by the PEX Committee, are wide-body captain, narrow-body captain, wide-body first officer, narrow-body first officer, wide-body second officer and narrow-body second officer. The PEX Committee

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* This date is used as opposed to, for example, September 1, 1991, because the record does not reflect the effect of the four parties' proposals on a date in 1991.

maintains that it brought 1061 entitlements to the merged carrier.

The PEX Committee's status-ratio proposal, if in effect on September 1, 1990, would have produced the following breakdown of the pilot seniority list: numbers one to 1635 would have been held by 457 PEX pilots in a ratio with CAL pilots; numbers 1636 to 2112 would have been held by 162 PEX pilots (FMRs) integrated with CAL and FAL pilots; numbers 2113 to 2223 would have been held by FAL pilots; numbers 2224 to 2513 would have been held by CAL pilots; numbers 2514 to 3154 would have been a ratio of FAL and CAL pilots; numbers 3155 to 3209 would have been held by FAL pilots; the remaining numbers would have been held by CAL pilots or reserved for CAL commuter pilots.

CAL Committee

The CAL Committee's proposed list is premised on the allocation of 631 positions to PEX pilots on the property on

October 23, 1987, when Bid 87-3 was announced. Based on the list used under that bid, the proposal awards Numbers one to 1660 to CAL (including NYA and FAL) pilots; numbers 1661 to 2018 are a ratio of 230 PEX pilots and 128 CAL (including FAL) pilots; numbers 2019 to 2463 are a ratio of 18 PEX pilots and 427 CAL pilots; numbers 2464 to 2514 are awarded to CAL pilots; numbers 2515 to 3723 are merged in a ratio of 393 PEX to 816 CAL; numbers 3724 to 3769 are awarded to PEX pilots; the 153

FMRs are slotted below those CAL pilots placed on the CAL seniority list prior to February 10, 1988, and they are merged in a ratio with 136 Continental Express pilots.

The CAL Committee's proposal, if in effect on September 1, 1990, would have tracked the Company's list as implemented from numbers one to 1575; numbers 1576 to 1893 would have reflected a ratio of CAL and PEX pilots; numbers 1894 to 2710 would have interspersed 13 PEX pilots with CAL (including FAL) pilots; numbers 2711 to 3623 would have been a ratio of CAL and PEX pilots; numbers 3624 to 3661 would have been held by PEX pilots; numbers 3662 to 3801 would have been held by CAL pilots; numbers 3802 to 4069 would have been a ratio of PEX pilots (FMRs) and Continental Express pilots.

FAL Committee

The FAL Committee's list, if effective on September 15, 1986, would have placed 609 PEX pilots below 557 FAL pilots. These pilots would have been followed by 119 FAL pilots, then 420 PEX pilots (including the FMRs).

This proposal, if in effect on September 1, 1990, would have resulted in: CAL plots holding the first 1450 numbers; FAL pilots holding numbers 1451 to 1575; CAL pilots holding 1576 to 1865: a ratio of FAL and CAL pilots from 1866 to 2506; PEX pilots from 2507 to 2877 (except for

2862 held by a FAL pilot); 2878 to 2931 held

by FAL pilots; 2932 to 3070 held by PEX pilots; 3071 to 3115 held by CAL pilots; and FMRs interspersed with CAL pilots from 3116 to 3941.

Positions of the Parties

PEX Committee

The PEX Committee's proposal is premised on the facts that in September 1986, the three carriers – CAL, NYA, and FAL, which compromise the list into which PEX pilots will be integrated – paid and staffed as captains 940 pilots (102 on international wide-body aircraft and 838 on other aircraft) while PEX paid and staffed 457 captains (52 on B-747s and 405 on narrow-bodies). Based on the combined total of 154 wide-body captaincies, the list should be merged so that the top 154 names include the 52 PEX pilots and the 102 most senior pilots on the CAL-NYA-FAL list, regardless of the carrier of ancestry of those 102 pilots. A date of hire list which included the PEX pilots would fail to deliver to PEX pilots the 52 wide-body captaincies and the 405 narrow-body captaincies they brought to the merger. Therefore, a status ratio is used to preserve the jobs and relative bidding power on each of the two lists, with the 52 PEX and 104 CAL wide-body captains comprising the most senior positions on the list. The next 1,243 most senior places combine the 405 PEX and 838 CAL other captain entitlement holders in an arithmetical ratio. This will preserve the precise access to

wide-body flying each pilot in this group had before the merger and distribute ratably as between the CAL and PEX

pilots the opportunities for bidding and other benefit selections based on seniority.

Continental decided not to buck the 1985-87 consolidation trend in the industry to achieve nationwide route systems and "critical mass." Texas Air gained a "turn-key" expansion into the dense New York City travel market which PEX already dominated through its Newark hub. It also gained the Newark-London and other PEX international routes, Terminal C, PEX's standardized fleet and the 1,061 pilots already trained on the aircraft in the fleet.

This was a merger of equals. While PEX had experienced some financial problems in the year preceding the merger announcement, it recorded net profits in three of the four years of its independent operations after its start-up year. Its operations were profitable on a net and operating basis in the second and third quarters of 1985, and it earned net and operating profits of $5 million and $11 million, respectively, in August 1986, the month before the merger announcement. Cash was stable from August 25 to September 15, at $13.3 million. The reality is that PEX never ceased operating and never filed for Chapter 11 protection.

Predicting the future course of any airline in the turmoil of this volatile industry is a very difficult

undertaking. The record reflects that PEX would have pursued two realistic alternatives other than liquidation if the TAC merger would not have been consummated. One was a merger with America West. The other was a "turnaround" plan. On the other hand, in predicting Continental's future without PEX, there are questions as to how it would have fared without the Newark hub, the PEX fleet and the dedicated PEX employees.

There is no seniority integration arbitration decision which discounts what the pilots from a carrier should receive in terms of a fair and equitable award on account of their

carrier's poor financial performance. Any such decision in this case would have no factual support in the record, no case precedent and no basis in logic or fairness.

The Company's claim that the imposed list must be fair because all four pilot groups oppose it certainly is no test of fairness. In fact, the other three pilot groups were pleased with the list after the PEX operation brought enhanced job opportunities and job security for them through, for example, the B-747s to which CAL pilots quickly gained access on former PEX routes. The 288 PEX pilots inserted at numbers 1678 to 1966 had no chance to fly the regular captain positions in Continental's other domiciles at Houston, Los Angeles, Denver or Honolulu. And not one of the PEX pilots other than these 288 is ahead of any CAL or NYA pilot hired before February 23,

1987.

On September 15, 1986, TAC promised the PEX pilots that the PEX and CAL seniority lists would be merged in a "fair and equitable" way. The promised seniority integration arbitration took place only after the PEX pilots commenced litigation, and the arbitration started three and one-half years after the promise.

TAC's control of PEX effective September 15, 1986 enabled it to renegotiate the purchase price for PEX. The September 15, 1986 Agreement and Plan of Merger gave TAC effective control of PEX. The lock-up provision of the merger Agreement itself prohibited PEX from soliciting other offers and required PEX to portray itself as a failing carrier. PEX's alternatives were, therefore, limited by the merger Agreement. Upon announcement of the merger on September 15, 1986, TAC took immediate control of PEX and utilized its assets to benefit TAC's other interests. In October 1986, TAC adopted a schedule for consolidation of operations at the outstations and immediately began consolidating those operations. TAC was also able to

eliminate competition by discontinuing PEX service to cities where PEX and Eastern competed. Continental also sent its representatives to meet with the Port Authority regarding Terminal C in July and October 1986, and on ten to 15 occasions between October 1986 and February 1987.

There can be no doubt that the operational changes

reflected an intent by TAC in the fall of 1986 to merge its airline subsidiaries as soon as possible. In October 1986 Continental announced that TAC would fold NYA, PEX and FAL into Continental. Steps were also taken to implement a merger of operations as soon as possible. TAC received certificates in the names of PEX and CAL to serve PEX routes from Newark to London and from the United States to Brussels, Luxembourg, The Netherlands, Shannon, Switzerland and West Germany. TAC also received the PEX exemption to serve Montreal from Newark. Effective November 15, 1986, TAC integrated the PEX Frequent Flyer program into the Eastern, CAL and NYA programs. In short, senior management at Continental was making preparations for the merger of operations with PEX almost immediately after September 15, 1986.

Every pilot seniority integration in the airline industry, except two, has been conducted under the fair and equitable standard. The two exceptions were NYA-CAL and FAL-CAL. This arbitration is the only arbitration at Texas Air conducted under the fair and equitable standard since the 1983 strike. During our/these bankruptcy proceedings.

In January and February 1987 the PEX pilots were being assured by PEX management representatives that TAC and CAL management were saying that the merger process was to be a "traditional" arbitration. In March 1987, a CAL management representative handed the PEX Committee the memorandum describing the imposed list.

The PEX Committee was not consulted about the imposed list. All but one of the people who determined how the imposed list would go together have numbers on the CAL pilot seniority list. The CAL Pilot Operations Group was given the opportunity to have input into the imposed list.

The FAL pilots were integrated under a JPA which, as Arbitrator Nicolau commented, did not provide a "level playing field" with "a considerable and obvious tilt in favor of the CO [CAL] pilots." Nicolau refused to include the PEX pilots despite attempts by the Company and the CAL pilots to do so in the PEX pilots' absence.

Continental should not now be permitted to take advantage of its strategy of delay in denying the PEX pilots an arbitration by urging that the imposed list should remain in effect because it will be a nuisance or an expense to change now.

As Arbitrator Bloch observed in the CAL-NYA decision: "There can be no question . . . that, both legally and by any other reasonable measure, [Continental] had started anew in 1983." Continental and Frontier had comparable hiring cycles, both in the percentage and number of pilots that they hired. People Express and New York Air also had very similar hiring patterns as start up carriers in the early 1980s with rapid advancement in the industry. CAL is similar, however, in that its hiring pattern peaked during the 1983-85 time frame which

also was the period of the bankruptcy and strike at Continental.

The industry-wide pilot preference for wide-body flying and the PEX contribution to the merged carrier of its London route, its B-747 fleet and its other vital assets are factors which strongly support the choice of a status-and-category ratio method of seniority integration. In the 1983 TI-CAL pilot integration arbitration, the 66 senior CAL pilots were placed at the top of the merged list because they

were international wide-body captains and because TI did not fly any international wide-body aircraft at the time of the merger. Pilot preference for wide-body aircraft pervades the industry for reasons including improved working conditions and higher pay, status or prestige and a "mystique factor". This preference also occurs at Continental, as confirmed by the CAL seniority list of June 1, 1989, on which 30 of the top 35 captains are staffed on wide-body equipment.

The fact that PEX contributed all eight B-747s to the merger makes doubly inequitable the Continental imposed seniority list which denies B-747 flying to PEX pilots accustomed to the acknowledged prestige and other benefits associated with B-747 flying. Conversely, CAL pilots achieved windfall gains and unfairly profited at the expense of PEX pilots. Seven of these B-747s which PEX operated in September 1986 comprise one-third of the wide-body aircraft then flown by the four merging carriers,

and produce 90 percent of the seats and 85 percent of the total capacity of the 14 DC-10s which Continental operated on September 15, 1986. The eight B-747s, together with existing PEX routes and its Newark hub, enabled Continental to expand into profitable markets which otherwise would have been unavailable to the Company.

In addition to the PEX fleet, Continental assessed the spare parts in the PEX inventory at more than $60 million.

A major contribution that People Express brought to the merged carrier was its Newark hub facility together with the market presence and power that PEX had built up at Newark. Terminal C, as planned and engineered by PEX, was a major asset in and of itself in promoting Continental's public image. Scandinavian Airlines System (SAS) joined with Continental because the SAS hub in Newark dovetailed so well with the extraordinary Terminal C facility. Continental also gained lease rights to significant hangar and storage space at Newark, sufficient ground equipment to

service the extensive fleet at PEX's hubs and out-stations, valuable take-off and landing rights at various slot-restricted airports, and gate space at London's Gatwick Airport.

A carrier's abilities to generate traffic, keep costs low enough to permit effective competition, and maintain a dominant hub to protect or expand its market share were critical to survival and growth in the

deregulated era for new entrants and established carriers alike. PEX was the only one of the four carriers to experience substantial, uninterrupted growth over the full five year period ending September 30, 1986, whether that growth is measured in terms of traffic, capacity or block hours flown by pilots. In five years, PEX reached a level of operations that permitted the DOT to place it in the category which the government defines as a "major carrier" – a level never approached by Frontier or New York Air. PEX produced an operating profit in four of its five years beginning with the fourth quarter of 1981 and ending with the third quarter of 1986. CAL and NYA produced operating profits in three of the five years, while FAL posted an operating profit in only one of the five years. Moreover, PEX showed a positive spread between its actual load factor and BELF in four of the five full years of its operations – the best performance among the four carriers. In sum, PEX was better able than the other three carriers to generate traffic and keep costs low enough to permit effective price competition during this five year period. PEX achieved this operational success largely in the context of stable finances, as indicated by its relatively low debt-to-equity ratio. While PEX may not have had the financial strength of some carriers in the industry, it was not as highly leveraged as Continental. Additionally, PEX brought crew costs to the merged carrier that were substantially lower than the industry average as a proportion

of transportation revenues, due to PEX's relatively greater efficiency and productivity. Similarly, aircraft utilization was also higher at PEX than at CAL or NYA. Finally, the importance of a dominant position at Newark, and by implication, in the New York market cannot be overstated in helping Continental to serve eastern markets in order to achieve sufficient mass to survive both in the national and international markets. International route authority was crucial for the near term future with respect to Atlantic markets, as well as having the ability to enter into cooperative marketing agreements with European carriers. It is true that PEX had problems in the year ending September 30, 1986, but that period coincides with its ill-fated acquisition of Frontier. The PEX-CAL merger relieved the PEX system of the burden of hemorrhaging attributable to the FAL operation and, at the same time, relieved Continental of a low-price competitor at its Denver hub. Claims that PEX was poised for imminent demise and that the valuable assets brought by PEX to this merger would have just disappeared are not plausible in light of airline industry history. Generalizing about a carrier's long term prospects from the financial situation faced by that carrier over a period of months ignores the basic strengths of the carrier built over a period of years. PEX did not have problems that were different from the other three carriers and, indeed, showed characteristics and assets in terms of performance over

a long-term, five-year period that were superior to those other three carriers.

When PEX and CAL merged, the PEX employees lost ground in the pay and benefits area as well as under Continental's personnel policies. PEX recognized that its most important asset was its employees, and it revolutionized traditional views of employee relations. The actual earnings of the PEX pilots, which were higher than those of the CAL

pilots prior to their merger, dropped as a result of the merger and the imposed seniority lists. The pay rates and other compensation plans of the PEX pilots were superior to those of the CAL pilots prior to the merger and dropped as a result of the merger. The base rate of PEX fifth year captains was $68,300, which includes the team leader override received by all PEX captains. The base rate for CAL fifth year captains was $50,000. After the merger was announced, PEX pilots took a pay cut to $56,250 in order to bring them closer in pay to the CAL pilots, and to $50,000 in 1987 to conform to the CAL pay rate. PEX fifth year first officer base pay was $48,500, (with a team leader override, $54,500) as compared to $40,000 for their CAL counterparts. Fifth year second officers at PEX had a base pay rate of $48,500 ($54,500 with a team leader override), while the CAL fifth year second officers received $35,000. Entry level pay for new hire pilots at CAL was $15,000 for the first three months, $18,000 for months four through six and $24,000 for months

seven through 12, and PEX paid $12,000 plus incentive pay for the first year. Although PEX pay rates rose consistently from 1983 to the merger, CAL pay rates dropped dramatically since the strike and bankruptcy in 1983, with barely any increase in the ensuing years. Moreover, CAL pay rates are substantially lower than the pay rates at other carriers, and Continental does not differentiate between wide-body and narrow-body pay rates as is common in the industry. PEX also had a variety of income incentive programs, while CAL has a profit sharing plan that is more restrictive than the PEX plan. PEX had a no furlough policy and a no downgrade policy, whereas CAL has had numerous pilot furloughs. PEX provided medical, life and disability insurance benefits that far surpassed those at CAL. THE SLIC bidding system enabled PEX pilots to prioritize their desires for the upcoming month through the use of a

computer syntax by which the lines of flying were build. A Custom Bidding feature permitted a pilot to work with a scheduler to build the best schedule based on the pilot's desires. On the other hand, CAL pilots bid for preconstructed lines, and improving one's schedule is based on a first come, first served basis through the "open window" period. Continental has unilaterally changed the work rules regarding seniority when it suited the Company to do so. The vacation, holiday and sick leave benefits at PEX were far superior to those benefits at PEX were far superior to those benefits at Continental. There was a unique relationship

relationship between PEX management and employees which resulted in cooperative labor management relations in a high quality work environment with significant opportunities for self-actualization – none of which were present at Continental.

On September 15, 1986, the FMRs were fully qualified pilots who met or exceeded Continental's real hiring requirements for second officers, and thus should be treated just like other second officers for purposes of seniority. At PEX, they were fully qualified commercial pilots with high expectations and excellent career opportunities. Immediately upon their arrival at PEX they were placed on the seniority list and began an intensive training program to prepare them to upgrade to first officer within approximately one year. Twelve FMRs became continental check airmen, several of whom gave line check instruction during the transition to CAL procedures. Others trained and gave final line checks to CAL 1987 and 1988 new hires being staffed as second officers. Continental did not distinguish the FMRs when it proposed to the Federal Aviation Administration reduced training for the PEX pilots for the changeover to CAL procedures. FMRs flew as second officers on the Continental side in January 1987 when they were needed to

staff the PEX B-747s and B-727s that TAC had given to Continental and which were being bid for the flown by the CAL pilots. Nonetheless, CAL management appended the FMRs to the bottom of the

seniority list and forced them to fly in a commuter operation before upgrading to first officer. The FMRs as a group were placed in a less senior position than an entire group of, at best, equally qualified CAL and FAL first and second officers hired prior to the merger. Because the CAL pilots hired after April 1987 were hired for the benefit of Eastern and not Continental, it would be unfair to place them ahead of the FMRs. Aside from the constructive notice these CAL new hires had in 1987, these pilots remain at Continental solely due t attrition and voluntary leaves. No arbitrator has ever looked behind an airline's hiring to assess the qualifications involved in merging pilot seniority lists.

A comparison of staffing at PEX and CAL on September 15, 1986 shows that the two airlines were staffed at virtually identical levels for their relative size. During the planning process, PEX used ratios to calculate flight hour utilization rates for line pilot staffing levels, with management flight crew members added separately. While People Express staffing levels reflected policies and characteristics specific to PEX, the resulting measurements were almost identical to CAL's. At CAL, the pilot system bids and the Pilot Employment Policy (PEP) Manual reflect an average ratio of flight crewmembers per aircraft of 5.27 to 5.29 counting all pilots. CAL's block hour utilization rate is indicated in several documents to be 64 flight hours per line flight crewmember.

In creating the imposed list, which credits PEX with 288 captaincies and FAL with 1677, the Company failed to

consider this parity of staffing between PEX and CAL. This resulted insignificant loss to the PEX pilots and a significant gain to the CAL pilots, as can be seen from computing the respective crew ratios of 3.60 and 9.16 (based on 80 PEX and 183 CAL aircraft), and average flight hours per captain at 81.32 for PEX and 27.42 for CAL. A CAL crew ratio of 9.16 would require 605 PEX pilots to fly even the 66 planes Continental allows us. Applying CAL pilots' 27.42 flight hour average to the number of hours flown at PEX in September 1986 (23,421) would require 854 PEX captains. Moreover, CAL's forecast of flight hours to be flown by a portion of the original PEX fleet in 1987 and 1988 reveals that the shortage of PEX captains for this purpose grew from 103 in June 1987 to 191 in September 1988. At PEX, the daily block hours to be flown by each narrow-body aircraft type was utilized to determine monthly block hours, and B-747 staffing used a total number of man days to be worked. A monthly flight crewmembers utilization rate was applied to the monthly block hour value to determine the number of line flight crewmembers, and the number of management flight crewmembers was then added to determine the total staffing required. The CAL methodology uses the forecast flight hours over a given time period and applies a flight crewmember utilization rate to determine the required number of line flight crewmembers. CAL staffs at a level

sufficient to cover the peak flying periods, and the management flight crewmembers are then considered separately. In the specific calculation of the imposed PEX staffing level, none of the 75 PEX Captains utilized in management function by Continental in March 1987 appears to be included. Additionally, the Company did not use its flight crewmember utilization rate in determining the number of PEX captains necessary to operate in the CAL system. Finally, PEX was given credit for only 66 of the 80 aircraft, the Company says, to account for aircraft transferred to NYA

and leased short term to Pan Am. Yet PEX captains flew some of these aircraft after their supposed transfer to NYA, and it appears that the leased aircraft were returned to Continental after a further extension of the leases. In the same way, the Company distorted the block hours projected for PEX pilots by using a 1987 timeframe which is not justified. Based on these considerations, and in the interest of fairness, the Company should have used the ratio method and the actual number of flight crewmembers paid and staffed at PEX and CAL (1061 PEX pilots and 2175 CAL pilots), with no need for any recalculation of the required or projected staffing levels.

Based on the foregoing considerations and analysis, the PEX Committee contends that its status and category proposal is fair and equitable because it preserves the relative positions of the pilots from each

group and avoids any windfalls to one pilot group at the expense of the other. The six categories in its proposal are: wide-body captain, narrow-body captain, wide-body first officer, narrow-body first officer, wide-body second officer and narrow-body second officer. Places on the merged list are given out to pilots from the two unmerged lists on an entitlement basis. That is, each pilot is assumed to bid the best job he can hold, in accordance with the established job rankings, and the array of names on the consolidated list derives from the principle that each pilot's unmerged relative percentile in his unmerged job will be preserved, as closely as is mathematically achievable, when the two unmerged lists are combined. Under the proposal, each pilot group can take advantage of its own attrition. The number of jobs used to create the ratios for the merged list are based on the jobs that existed before the merger announcement, as opposed to a prediction or projection of the future. The proposal is fair because it preserves each group's pre-merger access to preferred wide-body flying. A date of hire based integration

is unfair and inequitable to the PEX pilots who would be barred from access to the very aircraft they brought to the combined carrier, thus permitting the CAL pilots to reap windfall gains at the expense of the PEX pilots. Given the disparate origins and histories of PEX and CAL – one, a deregulation airline; the other, dating back more than 50 years – the more significant fact is

that a new airline began with Texas Air's acquisition of PEX, and its merger of PEX, CAL, NYA and FAL. Beginning on February 1, 1987, at the latest, pilots on both lists began accruing tenure and service with a new entity, whose pilot seniority list will be created through these proceedings. By preserving each pilot's relative standing in his status and category, the PEX proposal will distribute bidding power and jobs in precisely the same way the two separate lists did. We reject the other parties' proposals to integrate seniority lists on the basis of unreliable predictions about the economic futures of PEX and CAL absent the merger. It is not only unwise but unfair and inequitable to construct an integrated pilot seniority list based on the uncertainty of speculations about the future of PEX and CAL as unmerged carriers. Arbitral precedent supports the adoption of the status and category ratio list and counsels against the use of unreliable predictions about the unmerged economic prospects of merging carriers.

The constructive notice date for the merged seniority list should be September 15, 1986. All pilots hired after that date should be placed on the integrated lists, in date-of-hire order, below all pre-merger pilots. Because CAL did not hire any pilots between the TAC-PEX acquisition date and February 23, 1987, September 15, 1986 is functionally equivalent for constructive notice purposes to any later date up to February 23, 1987. As

of that date, any pilot applicant knew or should have known that his/her seniority rights would be subject to the superior rights of other pilots already employed by the merging airlines. Arbitrators have uniformly accepted the constructive notice doctrine and have ordinarily determined the merger announcement date as the constructive notice date. In this case, pilot applicants would have been placed on constructive notice through a series of events including: the TAC announcement, on September 15, 1986, of the PEX acquisition and merger with CAL upon consummation of the TAC-PEI merger agreement; the TAC-PEX joint application, filed on September 19, 1986 with the DOT, seeking approval of the acquisition; the DOT's tentative and final approvals respectively on October 14 and 24, 1986; the consolidation of facilities of CAL, NYA and PEX during the fourth quarter of 1986; the diverting of PEX aircraft via NYA to CAL; CAL pilots bidding on B-747s previously flown by PEX pilots; the merging of the PEX frequent flyer program with the CAL program in November 1986; and the PEX shareholder approval of the acquisition on December 29, 1986. After issuance of the March 12, 1987 list, management would have expected the Company's interviewers to advise all job applicants who asked that every pilot hired after February 1, 1987 would be placed below all PEX pilots and FMRs. The contingencies contained in the merger agreement were the normal contingencies and conditions that would take place in any financial transaction

of this size and complexity and which, at most, added time, but not uncertainty, to the final outcome which was resolved on December 29, 1986 by the PEX shareholder approval. An objective pilot applicant at Continental on September 15, 1986, or as late as February 22, 1987, should have reasonably believed that the likely outcome of the TAC-PEI merger agreement would result in the integration of the operations and pilots of PEX and CAL. Therefore, it would

have been unreasonable for an applicant to wait until October 1987 before realizing that his/her seniority rights might well be subject to the superior, pre-existing seniority rights of another pilot group. In this regard, it would be particularly inequitable to elevate the CAL pilots hired after April 1987 as potential strike replacements for Eastern, as they were surplus to Continental's operational needs.

The Company's list is unfair and inequitable. It was not compiled as a result of mutual negotiations and mediation or arbitration. Instead, it was unilaterally created by CAL management – specifically, by four CAL pilots whose names appear on the list – and imposed upon the PEX pilots despite their opposition. The use of such a list created by self-interested decision makers is unfair and denies the PEX pilots their right to due process. Thus, there is an unavoidable inference that CAL's decision-makers were not acting in the interests of PEX pilots. Accordingly, the list should be summarily rejected.

64

The Company's list should also be rejected because it was created in breach of the LPA and in violation of the industry standard of a fair and equitable integration procedure. There is absolutely no precedent for the unilateral manner in which Continental constructed the list. The PEX pilots had no meaningful input into its formulation. Continental's reliance on the allegation that PEX would have gone bankrupt and ceased operating but for the merger as a purported justification for its derogation of the PEX pilots' seniority rights is unsupported by the facts for the case precedent. A carrier's financial condition deserves little or no weight when merging pilot seniority lists. Continental desperately needed PEX to survive in the deregulated environment, and the merger of PEX and CAL should be viewed as the joining of equals. Continental cannot show that PEX would have gone into bankruptcy and ceased operating but for the merger, even if it were appropriate for CAL to take into

account its supposedly superior financial condition to PEX, which it is not. Continental has had a planned strategy for delay in this case, and therefore the fact that its unlawful list has been in effect for four years should be given no weight. Indeed, the Company should be stopped from arguing that its imposed list should be upheld on the ground that it has been in use for four years.

The Company's list should also be rejected because it arbitrarily places CAL pilots ahead of PEX pilots with

the same or higher status, seniority and experience, substantially decreases the PEX pilots' relative position and permits CAL pilots to reap windfall gains at the expense of PEX pilots. In compiling the imposed list, the CAL decision-makers focused almost exclusively on the allegedly disparate economic conditions of the two airlines to the exclusion of other relevant factors such as length of service, relative position on the unmerged lists, and status achieved at the pre-merger carriers. Under the imposed lists every PEX pilot loses relative position. Despite the wide-body jobs that PEX pilots brought to the merger, for example, the lists denies any of them from achieving any of their entitlements to the more desirable positions. The Company downgraded approximately 150 PEX captains and placed them junior to all CAL and NYA pilots hired before the merger announcement. In so doing, the Company split the PEX April 25, 1983 training class of pilots, with the anomalous result that one class member (number 300 on the PEX seniority list) is now number 1977, and another (number 301 on the PEX list) is now number 2857 on the integrated lists.

The Company's list also artificially enlarged the CAL captain class and artificially reduced the PEX captain class. The former was increased from 857 pilots actually trained and flying as captain on September 15, 986 to the

top 1677 positions on the imposed list.* The latter was reduced from 457 to 288. According to the PEX Committee's analysis, 1299 captain slots, including management, were awarded based on present and future captaincies on Bid 87-1, effective December 1987. Therefore, since the number one PEX seniority holder does not appear on the merged list until number 1678, at least 378 pilots who did not even hold a future captain bid were placed ahead of him. CAL pilots were allotted 1677 captain positions based in part on the planned delivery of aircraft in 1987, which did not arrive, and the additional transfer of aircraft (five B-747s and six B-727s) from PEX. The reduction of the PEX captain class was accomplished without talking to a single PEX line pilot and was fraught with inaccuracies and inconsistencies – not the least of which were the reliance on, and a misunderstanding of, only one month's statistics, and a misunderstanding of PEX's manning and staffing calculations.

Under the Company's list which resulted in the PEX pilots' loss of relative position, they enjoy few benefits from working for the merged airline – especially with regard to bidding different types of equipment and holding different domiciles.

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* CAL bid 85-5 projected 857 captains at Continental on November 1, 1986. As of September 1986, Continental paid and staffed only 772 captains. According to the Block Award, NYA had 168 captains on that date. Since the PEX merger, however, Continental has needed to promote CAL pilots to fill the downgraded PEX captains' positions.

The Company's list is unsupported by any precedent, including the cases it has cited. In the CAL-FAL pilot case, Arbitrator Nicolau observed that the JPA and its Sideletter imposed restrictions not found in other proceedings, resulting in a considerable and obvious tilt in favor of the

CAL pilots. For example, he was required to take special notice of the non-operating status of Frontier and the limited employment prospects for FAL employees resulting there from; and as a result, give this fact greater weight than the expectation that Continental's competitive position would be enhanced. Even more damaging to the FAL pilots was the requirement to ensure no dilution or adverse impact on the promotional expectations of CAL (including NYA) captains and first officers based on all aircraft in service or on firm order or option to Continental. The CAL-PEX flight attendant case is not a useful precedent because, like the FAL pilots, their arbitrator's mandate required him to consider factors beyond the fair and equitable standard. Moreover, the PEX flight attendants were grouped in a single job description (Customer Service Manager) and were subject to different economic and non-economic benefits from those of the captains, first officers and second officers whose progression in status and careers are more significantly determined by seniority. A third distinction was the PEX practice of cross-utilization whereby 15 to 20 percent of the Customer Service Managers worked in jobs which did

not involve flying. Finally, the CAL-PEX flight attendant hearing lasted only six days, whereas the record of the instant case is far more complete with respect to the financial condition of the two airlines involved in the merger, among many other things, and the many economic benefits brought to the merged carrier by PEX and its employees.

The CAL Committee's proposal is even more unfair and inequitable than the Company's proposal, and therefore should be rejected. The primary factor which the CAL Committee used in constructing its proposal was the contention that PEX as an airline had failed, and that therefore the PEX pilots had no career expectations and were entitled to nothing by way of seniority integration. Although

PEX experienced some financial difficulty during the year preceding the announcement of the TAC merger, the fact is that PEX was a going business at the time of the merger, which, unlike CAL and FAL, never sought Chapter 11 protection. Continental's financial history (and current status) hardly places it in a position to assert that its financial condition was superior to that of PEX. Nor are FAL and NYA pilots entitled to seniority preference over PEX pilots. FAL had already filed for bankruptcy protection at the time of its operational merger with CAL. NYA as well was having serious financial problems at the time its operations were merged into Continental's in early 1987. The CAL Committee's

proposal uses a variety of methodologies, manning levels and different system bids for determining the number of CAL pilots and the number of PEX pilots. System Bid 87-3 (October 1987) was used for determining CAL pilot utilization, but the month of December 1986 (the industry's seasonal low point month) was used for PEX. System Bid 88-1R (a reduction bid) was used to determine the number of PEX pilots eligible for captain positions. The CAL commuter staffing levels were used in determining the FMR placement. Neither date of hire nor length of service nor position achieved was given any significant consideration under the CAL Committee's proposal. It would have been better for a pilot hired by PEX in 1983 to have quit PEX as a captain after the acquisition and then gone to work at Continental in 1987, because he is ranked beneath CAL pilots hired by Continental in March 1987. The CAL Committee's list is totally unfair to the FMRs in view of their hire dates, qualifications or experience, as well as under the constructive notice doctrine.

The FAL Committee's proposal improperly tries to reverse the impact of the CAL-FAL award which was not a product of the PEX pilots' proposal in this case, nor of any

PEX actions. This Arbitration was intended by the Court to be a two-list integration involving CAL and PEX. The FAL pilots' participation is solely as a component of the CAL list. The FAL Committee's proposal imposes inexcusable and irresolvable equities on the PEX pilots who

would lose 1,000 seniority slots and be covered under a useless 'fence" which creates additional inequities and will spawn future arbitrations. The FAL Committee's proposal simply ignores all FMRs under its "date of commitment" method which recognizes FMRs on the date they completed their training, as opposed to the date they entered training.

CAL Committee

The CAL Committee determines that 641 PEX pilots (248 captains, 230 first officers and 163 second officers) were entitled to placement on an integrated list. Its figures are based on the actual block hours flown by PEX in December 1986, as opposed to the Company's approach which used 1987 projected monthly block hours. The CAL Committee also uses the actual CAL pilot utilization rates, as opposed to the Company's use of the PEX monthly utilization rates. It adds a five percent factor for management pilots, which approximates the number at Continental. This reflects the fact that the PEX pilots would be employed under Continental work rules and subject to this management structure.

The CAL Committee premises its list on the date of October 23, 1987 – the date of Bid 87-3 which was the first combined seniority event involving CAL, former FAL and former PEX pilots.

The former PEX pilots are integrated by status to

the extent that 230 of the 248 captains are ratioed with 128 CAL captains in the group of captains immediately below the last former FAL captain. Those 128 CAL pilots had held captaincies as a result of Bid 87-3. The remaining 18 PEX captains are then ratioed with 427 CAL pilots who had held captain seats as a result of Bid 87-3, but lost them in an overall seven percent decrease on reduction Bid 88-1R. The 393 PEX first officers and second officers are ratioed with 816 CAL first officers and second officers – ending with the last pilot Continental hired prior to Bid 87-3. The remaining 51 former PEX pilots employed on October 23, 1987 follow in a block. The FMRs are placed on the merged list, effective February 10, 1988 – 58 weeks after TAC acquired PEX and the earliest time at which the FMRs could achieve full commercial pilot qualification under Continental's training program. They are ratioed with 136 CAL commuter pilots.

Arbitral authority establishes that to be "fair and equitable", the integrated seniority list must recognize and protect the career expectations which each competing group might reasonably have anticipated had the merger not occurred. The application of this common sense principle is not simply a matter of mechanically counting airplanes and pilots. Rather, some assessment must be made of the probability that those airplanes would continue to provide work and promotions for those pilots if no merger

had occurred. While such an assessment cannot be based on an exact science, the evidence in this case is overwhelming and largely uncontroverted that the PEX pilots had virtually no realistic expectation of being able to continue their careers as airline pilots with People Express after December 1986. In other cases, each partner has brought different strengths and different weaknesses, and the resulting combination was likely to be stronger than either of the pre-merger components. Moreover, none of the contending

pilots were saved from unemployment by the merger in question and all had reasonable expectations of continuing their careers.

The proposed seniority list offered by the CAL Committee will afford each of the affected pilot groups the opportunity to realize the career expectations each might reasonably have expected had the merger not occurred.

A fair and equitable list must equitably apportion the opportunities for advancement and the consequences of retrenchment. The CAL Pilot Committee proposal places 230 PEX pilots on the combined list in the top 2,000 positions – within the lower 20 percent of the hard captaincies at Continental. These PEX captains, however, ought not be permitted to outbid any CAL captain whose captaincy predated the award of Bid 87-3 – when the pilot forces were combined. To allow otherwise would constitute a classic windfall to PEX pilots who would never have had an opportunity to claim any of Continental's eight bases

or equipment. Because slightly different considerations apply to those CAL pilots who first attained captaincies on Bid 87-3, they are ratioed with the 230 PEX captains so that career progressions are shared. The corollary premise – sharing of downside risk – underlies the separate ratio of the 18 PEX captains and the CAL captains who were unable to hold their Bid 87-3 captaincies through Bid 88-1R, so that any future reduction in that "fringe captain" area will be borne ratably by CAL and PEX pilots. A similar approach to assure no windfalls is used in the integration of the first and second officers, with all PEX pilots lower than all CAL pilots who had become first officers prior to the award of Bid 87-3, followed by a ratio of PEX and other CAL pilots in first and second officer positions. As of September 1, 1990, every PEX pilot in this last ratio would have had sufficient seniority to hold a first officer position. The final group of PEX airmen includes those individuals who would certainly

have lost their jobs absent the merger. Therefore, these "constructively furloughed" pilots are placed at the bottom of the Continental list in October 1987, at the time of Bid 87-3. This last group includes the FMRs who, even under the People Express plan for them, would have been sent to commuter subsidiaries to accumulate piloting experience prior to becoming first officers. In 1987 and 1988, the FMRs were not qualified, by CAL's standards, to occupy any pilot position on the airline; yet they were given seniority

position which allowed them to accrue competitive pilot seniority, thus producing a clear windfall, while they were gaining experience at CAL commuter lines. For this reason, they are assigned a seniority date of February 10, 1988, which was the earliest date on which any FMR could theoretically have completed the CAL commuter training if, indeed, CAL had begun the program in 1987.

Concerning exposure to retrenchment in an industry where careers are not as stable and secure as they once were, the CAL Committee's proposal places the PEX pilots in far safer positions – with a cushion of more than 1,100 pilots junior to the last hired PEX pilot – than they occupied at PEX prior to the acquisition. The FMRs will senior to nearly 750 CAL pilots.

The principle of "constructive notice" does not prohibit implementation of an otherwise fair and equitable integrated list in this case. The notice underlying this principle is that pilots hired by an airline after that airline has publicly made clear its intention to acquire – and merge with – another airline, ma fairly be charged with notice that their seniority interests may be subject to the seniority claims of the pilots already employed by the to-be-acquired airline. That doctrine, however, does not arise until such time as an objective observer, having access to the publicly-available information a pilot applicant might have, ought reasonably to have concluded that an operational merger of the affected

pilot work forces

75

would occur. Throughout most of 1987, the operational merger of PEX and CAL was in doubt. The PEX fleet was "fenced" from the combined CAL/NYA/FAL fleet, and staffed and flown exclusively by PEX pilots until October 1987. At that time, the operational merger became a reasonable certainty. Secondly, the doctrine simply imputes notice of the pendency of a merger, as opposed to establishing the seniority equities of the to-be-acquired pilots as superior to those of the "on-notice" pilots at the acquiring airline. In this case, the PEX pilots had neither secure jobs nor reasonable expectations for career advancement, and nothing in the constructive notice doctrine relieves the Arbitrator from giving those facts determinative weight. Finally, the claim of constructive notice has no applicability to issues raised by the presence of the FMRs who were not pilots at People Express.

The proposal of the PEX Committee fails to satisfy any of the recognized criteria of fairness and equity. The proposal, attrited for currency to September 1, 1990, includes every PEX pilot and all but 33 of the FMRs (hired after June 29, 1986) in the top 2,000 hard captain positions. It bumps out of captain seniority hundreds of CAL pilots who held that status long before People Express was acquired b TAC.

The Company imposed list does not fully satisfy the fair and equitable standard. It credited the PEX pilots with more captains than People Express legitimately

76

required in December 1986. The Company's calculation was based on a projection of the flying planned for the former PEX fleet in the summer peak period of 1987. By that time, however, PEX planes and pilots were flying routes they had never flown before, where they replaced flying formerly

done by CAL planes and pilots. Additionally, the Company accommodated a PEX request to protect a PEX pilot in captain seniority, resulting in further inflation of the PEX captain entitlements. The Company also failed to consider the CAL captain reductions required by Bid 88-1R, which did not reach any PEX captain protected by the Company's list. As a result, the CAL pilots absorbed all of the adversity, and the CAL Pilot Committee's proposal attempts to remedy this defect through its ratio method. Finally, the Company's list gives an unwarranted windfall to the FMRs, who were placed in a block senior to hundreds of fully qualified pilots hired by Continental in 1987 and 1988.

The FAL Committee, operating under the constraints imposed by the Court's Order, has made a persuasive case for its proposal, particularly in the way it has structured the relationship between the former FAL and PEX pilots.

FAL Committee

The District Court saw the need for construction of a list that was not only fair to the PEX pilots in relation

to the CAL pilots, but a list that was also fair and equitable to the FAL pilots in relation to the PEX pilots. The FAL Committee is a full party to this proceeding, with the sole caveat that it would be bound by the Nicolau award.

The relevant histories of PEX and FAL and the transactions between themselves and CAL demonstrate the superior equities of the FAL pilots. Since its inception in 1946, FAL had enjoyed a long and profitable history, while PEX was a risky start up operation in 1981 and began a course toward financial oblivion after some brief successes. The FAL pilots hired prior to 1983 believed they were employed by a stable, mature and historically profitable enterprise, while every PEX pilot knew the uncertainty of the airline under deregulation with an unorthodox management

style. The trade off for becoming "instant" captains was the risk inherent in an operation with no history of profitability. The FAL pilots absorbed a series of wage reductions and working condition modifications prior to the PEI buyout. The FAL pilots and other FAL employee groups negotiated an agreement wit PEI in October 1985. The agreement provided that: (1) FAL pilots would continue to receive the pay rates, benefits and terms and conditions of employment contained in the ALPA agreement at Frontier; (2) FAL pilots would be covered by a "no furlough" agreement absent unusual specified conditions; (3) PEI would not sell FAL assets over $25 million and would maintain a minimum aircraft fleet at FAL; (4) PEI would operate FAL as a separate

entity until at least February 1, 1990; (5) PEI would not, in effect, sell stock of FAL to TAC-CAL; (6) PEI would provide FAL with operating funds and enhance FAL as a viable carrier; and (7) In the event of a merger of PEX and FAL operations, the seniority lists would be integrated in a fair and equitable manner by arbitration if necessary. These provisions extended better rates of pay, benefits and terms and conditions of employment to the FAL pilots than the PEX pilots enjoyed.

PEI violated ever term of the October 1985 agreement.

When PEX took over FAL, FAL lost all control over its own destiny, and PEX, largely employee and pilot owned, ran FAL in to the ground and ultimately shut it down in a misguided bargaining tactic during the negotiations for its sale to United. While FAL had an operating loss of $40.7 million in the first three quarters of 1986, PEX had operating losses in the same period of $120.1 million. Thus, the FAL losses were more than offset by just the $46 million PEX took from the sale of FAL assets to UAL, and there is no basis for the claim that the FAL operation was bleeding PEX's cash position. Indeed, in June and July 1986, FAL

was actually transferring money back to PEX.

Texas Air's proposal on September 15, 1986 required that the purchase of People Express could only go forward after the sale of Frontier, the signing of the JPA and a

waiver of claims by the FAL employee unions. The terms of those documents included: (1) termination of the FAL-ALPA agreement and agreement to CAL wages and working conditions, including no longevity pay for FAL pilots; (2) termination of the pilot retirement funds; (3) termination of the October 1985 agreement with PEI, including the no furlough agreement; (4) waiver of all soft claims against TAC/CAL/PEI valued at $145.6 million for the pilots; and (5) a seniority integration arbitration procedure requiring the arbitrator to recognize the non-operating status of FAL and the entitlement of the CAL pilots to certain aircraft on order to CAL as of September 15, 1986.

As a matter of equity, there is no way that the FAL pilots as a group can be placed junior to the PEX pilots whose very jobs and "fair and equitable" seniority integration depended entirely on the FAL pilots execution of the JPA. PEX negotiated away the seniority rights of the FAL pilots when it violated (without PEX pilot protest) every provision of the October 1985 agreement and by October 1986 had no cash or other assets to pay the FAL pilots for those violations.

A comparison of the assets brought to the merger by FAL and PEX demonstrate the superior equities of the FAL pilots to the PEX pilots. FAL brought to the merger a much newer and homogeneous fleet than did PEX, and the Company erroneously gave PEX credit for five B-747s. FAL

contributed its modern terminal and facilities at Denver,

while PEX never operated out of Terminal C or paid for any of its construction. Frontier's turnkey operation enhanced its value to CAL, in contrast to the serious serve problems encountered in the integration of PEX. Continental's exercise of the option to buy Frontier stock added significant value to the deal when TAC changed the nature of the transaction from a purchase of assets to a true merger. As a result, TAC/CAL became the debtor-in-possession of the Frontier estate of $112.6 million. TAC/CAL gained a total $8 million from the over-funding of the pilots pension plan and related actions – more than CAL paid out to the PEX pilots in debt forgiveness. The values of People Express and Frontier viewed by themselves and interested third parties have been consistently higher for FAL than PEX, even after FAL was placed in bankruptcy.

The pilot equities of the FAL pilots are vastly superior to those of the PEX pilots when measured by the primary factor of date of hire/length of service. There is no fundamental inequity in this case that should obviate the use of this factor in constructing a seniority list. People Express was, like Frontier, a carrier with an uncertain future. If FAL brought no real jobs to the merger because it was shut down, then certainly neither did PEX, which would have liquidated within weeks, if not days, after the failed attempt to sell Frontier to United.

81

Also, the evidence is overwhelming that PEX would not have been purchased by CAL had not PEI also owned FAL and had no the FAL pilots agreed in the JPA to have FAL assets transferred to CAL.

The promotional expectations of the FAL captains were to remain captains and retire at age 60 as captains, and those of the FAL first officers were to promote to captain due to the normal age 60 attrition within the captain ranks. This natural expectation was not the case among the younger PEX group in their overstaffed system. The FAL proposal

enables the FAL pilots to live out their careers with some minimal dignity rather than stripping from them what little remains in the aftermath of the CAL-FAL award. The PEX first officers should be satisfied with the promotional expectation they currently have – a promotion to captain which they would have been unlikely to achieve at PEX for another 20 years if the airline had survived.

The vastly superior pay and benefits of the FAL pilots coupled with their length of service were factors in Continental's decision to give the PEX pilots full longevity for purposes of pay and benefits and to deny the FAL pilots this longevity. Arbitrator Nicolau found that any consideration of longevity pay based on general notions of equity and fairness was foreclosed by the language of the JPA. In the present Arbitration, where the only standard is the notion of fairness and equity, there is no such

preclusion. The District Court's Order does not preclude the FAL pilots from seeking a longevity pay level comparable to their counterparts at CAL and PEX. This request harms neither of these groups, and would have no back pay consequences to the Company if implemented on a prospective basis.

There is also a great disparity between PEX and FAL with regard to working conditions, including retirement and contractual benefits. FAL's benefits were consistent with the benefit packages extended by other major airlines operating under a union contract. Beyond that, the FAL pilots were contractually protected under the October 1985 agreement. The FAL retirement plan was spectacular, with most senior of FAL pilots receiving over $500,000 in vested retirement benefits, and a pilot at the top third has received between $165,000 and $204,000 upon retirement. This is in stark contrast to the PEX pilots who had no retirement plan.

The "sweat equities" contributed by the FAL pilots far exceed those of the PEX pilots when considering: the series

of wage reductions and work rule modifications totaling $47.8 million for the pilots; the damage resulting from PEI's violations of the October 1985 agreement; and agreement to the JPA. With respect to the PEX pilots, there is no showing of any willingness to make wage and work rule concessions until a wage cut was instituted in late 1986 when it was too late. Indeed, instead of

giving up sweat equity, the PEX pilots were personally awarded $8.2 million in debt forgiveness and $3.2 million in related taxes as well as full longevity for pay and benefit purposes.

Although domicile is not controlling issue, it is relevant to the extent that the FAL pilots were based in Denver and the PEX pilots were based in Newark. The FAL Committee has proposed a fence (with restrictions) for the benefit of PEX pilots who shall be entitled to be awarded a maximum of 295 captain vacancies in the Newark base regardless of their system seniority in relation to all other CAL pilots, including FAL pilots.

A staffing comparison reflects that Frontier was lean and understaffed while People Express was greatly overstaffed and required 232 captains based on actual staffing requirement at PEX in December 1986. For a virtually defunct airline, the actual December 1986 staffing is an appropriate yardstick.

The FAL Committee used the following criteria in structuring its proposed integrated lists: (1) The integration proposal must be fair and equitable to each pilot group. (2) It must primarily recognize length of service as a pilot. (3) It should seek to: preserve jobs; avoid windfalls to any group at the expense of the others; maintain or improve pre-merger pay, standard of living and pre-merger pilot status; and minimize detrimental changes to career expectations. (4) It should accomplish the above

by reference to the economic condition of the airlines involved (and the reasons therefore), the equities that each airline and pilot group brought to the merger, and the nature of the transaction that resulted in the merged airline. (5) All attrition occurring within each pilot group after the effective date of the transaction resulting in the merger should be regarded as a benefit to be shared equally by all pilot sand not by any single pilot group. (6) The resulting integrated list should continue to be fair and equitable during the entire careers of all the pilots on it.

Even under a finding that FAL and PEX were "in the same boat" in terms of financial strength, a date of hire or length of service proposal would be favored because both carriers would be regarded as similarly situated.

The quid pro quo sought for the fence protection is that the named FAL pilots from the March 12, 1987 list between numbers 163 and 202 who remain on the list as of the date of this Award be pay protected as captains until the pilot either receives a captaincy or is entitled t a captaincy and declines such vacancy. At present, there are 25 such pilots who not only were flying as captains on FAL before the shutdown, but who were entitled, using the PEX staffing ratio (295 captains divided by 60 aircraft equals 4.92 ratio), to captain positions at FAL (41 aircraft multiplied by 4.92 equals 202). In other words, if 295 (now 219) captain jobs are to be

protected, at least 25 more FAL pilots should be pay protected as captains.

The Company's list is unfair and inequitable t the FAL pilots. It fails to give appropriate deference to date of hire/length of service. It gives B-747 positions to PEX pilots after previously allocating them to CAL pilots. It improperly integrates PEX flight engineers with FAL pilots. It erroneously placed all FMRs in a block after the last FAL pilot when they were not industry-qualified pilots and lacked the experience and qualifications that Continental required of

its own 1987 new hire pilots.

The Company

As in all prior airline arbitrations, the Arbitrator's duty here is to fashion an integrated seniority list that preserves the pre-merger career expectations of the respective pilot groups. The primary considerations in making this assessment is the economic viability of the carriers at the time of the acquisition and in the few years immediately preceding. This clearly is the standard because an airline pilot's career expectations are tied (for better or worse) to the economic health and future viability of his or her airline. The PEX pilots have the burden of proving that they had good promotional expectations. In the summer of 1986, the career expectations of the CAL pilots were strong and

growing, and Continental did not need to acquire PEX or any other carrier to survive and reach its present size. PEX and FAL pilots are now largely first officers and captains in the nation's fifth largest airline. Newark is only a part of Continental's system, which includes major hubs and facilities at Houston, Denver and Cleveland and major international operations in Mexico, Japan, the South Pacific, Latin America and Europe. By year-end 1985, Continental had developed a worldwide network of operations, without any help from PEX, including 52 domestic and 28 foreign cities. In particular, CAL also commenced service from London to Houston. During 1986, Continental added 30 new destinations. On September 5, 1986, the DOT granted Continental a Denver to London route. By year-end 1986, CAL was about double the size of PEX. It could have simply sat back and waited to pick up PEX's aircraft and facilities after liquidation, which was assured. Neither TAC nor CAL had the power to, nor did they, exert control over PEX's operations before the acquisition was consummated.

In fact, the merger announcement actually helped PEX's situation, as did Texas Air's $107 million in cash infusions between September 15 and December 18, 1986. In September 1986 and thereafter, PEX had no alternatives to liquidation other than TAC.

On February 1, 1987, PEX began operations under the Continental name, and the problems of PEX were thrust upon Continental, including an operational nightmare in Newark

that severely damaged Continental's reputation and caused it hundreds of millions of dollars in lost revenue, as well as onerous operational contracts and facilities leases that were inherited. By early March 1987, the PEX Committee had rejected the NYA-type integration structure. After discussions and meetings with the pilot group representatives, the Company made a good faith determination that it was in the best interest of the airline for management to itself construct an integrated list rather than go through yet another divisive arbitration, which would indefinitely delay the promulgation of a combined list and the benefits to all pilot groups that such a list would provide.

The first step in the Company's list was the determination that Continental could utilize 295 PEX pilots as captains and 779 pilots in total, according to CAL's utilization of the PEX fleet. The Company also adopted PEX Captain Fred Abbott's input as to the number of captaincies the PEX pilots should receive.* The staffing determination was made using the method by which CAL's own staffing requirements were determined. The number of block hours used produced the same number of captain positions to which the PEX pilots would otherwise have been entitled had PEX been able to survive independently.

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* Captain Abbott was the number 12 pilot on the PEX seniority list and Chief Operating Official for PEX at the

time. He was also the founder of the PEX Committee.

88

The pilot utilization rate applied in the staffing determination was also fair and equitable because it was consistent with CAL's utilization rate for its own pilot work force. The 295 PEX captains were to be placed junior to the last CAL captain on Bid 87-1; the PEX non-captains hired before the acquisition; and the FMRs were to be placed after all the integrated non-captains but before any 1987 hires. None of the 950 PEX pilots remaining on March 12, 1987 was furloughed, despite CAL's need for only 779 PEX pilots. The CAL-FAL award placed 162 former FAL captains after the last CAL captain awarded a captaincy on Bid 87-1. The award then reserved a block for CAL first officers based on new equipment coming to Continental, followed by a ratio of remaining CAL and FAL first officers, and concluded with recent FAL hires at the bottom but before the 1987 CAL new hires. The Company believed that Arbitrator Nicolau's approach ratified the fairness of its proposed CAL-PEX list. On June 30, 1987, Continental held a meeting of the pilot groups in Houston and removed itself from the process, hoping that the CAL and PEX Committees could work out a list. When they were unable to reach any agreement, the Company was faced with the decision of how to integrate its March list with the CAL-FAL award.

The Company tried to look at all of the respective equities existing between the PEX and FAL pilot groups.

89

Frontier and PEX were not that far apart in value, as established by the fair market prices of $158.1 million for Frontier and $122.1 million for PEX (including Britt and PBA). Both were national airlines, as opposed to majors. Both carriers had failed. Neither pilot group had employment prospects. They both moved from a one-hub

carrier to a multi-hub carrier with more equipment. FAL pilots waived claims allegedly worth up to $141 million, whereas Continental forgave PEX pilot stock debt of $8.2 million and paid $3.2 million in taxes on the debt. FAL pilots lost their retirement, and PEX had no such fund. The FAL pilots had traditional job duties, and the PEX pilots were no longer cross-utilized. The PEX pilots gained traditional seniority which the FAL pilots already had. The PEX bid trips by lottery, whereas the FAL pilots used seniority. The top FAL captains were hired in 1955-56 and the top PEX captains in 1980-81. The bottom FAL captains were hired in 1968, and the bottom PEX captains in 1983. FAL was a long-term carrier with status earned over time, and PEX was a "start-up" carrier with "instant" captains. The FAL pilots had overall superior longevity as compared to the PEX pilots. In short, the PEX pilots obtained more than the FAL pilots from the acquisition by virtually every measure.

The Company decided that a fair solution was to integrate the FAL and PEX captains and non-captains by date of hire and place the FMRs below all other pre-acquisition

pilots but ahead of the 1987 CAL new hires. This list, in force on the property for more than three years, is very fair. It places the PEX captains in the "hard" captain seniority range without encroaching on the superior career expectations of the CAL captains. The fairness of the list is affirmed b the subsequent integrations of the PEX flight attendants and ground agents, both of which groups received considerably less favorable treatment than the PEX pilots. Of equal importance, the Company's list also properly balances the equities of the pilots from the two failed carriers, PEX and FAL, relative to each other. It also properly places the FMRs giving due account to their unfinished training and most junior status at PEX, while

placing them ahead of pilots who were hired by the Company at a later date.

Since the Company's list is fair, it should not be changed to one of the pilot proposals even if any one of them were also fair (which none of them is). Arbitral precedent defines the Arbitrator's charter not to devise a perfect list, if such a thing exists, but one that is fair and equitable on the whole. The District Court's standard of "fair and equitable," an undefined term common to all prior arbitrations, requires the outcome to be "fair and equitable" in its totality; it is not limited to the effect on the pilots. Under the Order, the Company is an equal party to this Arbitration. Under the fair and equitable standard, there is no rationale for

saddling the Company with the operational and financial costs that would be associated with moving from one list to another, even assuming that one of the pilot committee proposals were also fair.

The three pilot committee's proposals are flawed in a variety of ways. The PEX Committee ignores: (1) the economic condition of the carriers and the relative promotional expectations of their pilot groups; (2) longevity, especially with regard to the FAL pilots; and (3) the benefits that they received from the acquisition. Furthermore, there is no factual basis for the PEX Committee's distinguishing between wide-bodies and narrow-bodies (while at the same time excluding A-300s from the wide-body category), particularly at Continental where no base pay differential exists for flying wide-bodies and where pilots do not "chase equipment". In addition, the use of post-merger attrition in the manner utilized by the PEX Committee's proposal has been rejected by arbitral precedent and is on its face, unfair to CAL and FAL pilots. Nor is there any validity in the PEX Committee's use of 1,061 PEX pilots employed in September 1986, when the Court has determined that the Committee only lawfully represents the 950 pilots who were

employed at Continental on March 12, 1987.

The Company's list is fair and equitable because it fairly balances the expectations of pilots from a failed carrier with those from a growing carrier, and it fairly

balances the equities of pilots from two failed carriers.

The Company's list also fairly places the FMRs behind the other PEX pilots but ahead of new hires, and it does not integrate the FMRs with the FAL pilots by date of hire. At the time the FMRs joined Continental, they were not qualified to fly as first officers under CAL's flight time requirement of 2,500 hours in 1987. Therefore, Continental sent them to its commuter operations in order to gain additional flight experience, just as PEX intended to do in 1986. In addition, the FMRs joined PEX during the period when it was experiencing its financial downfall. Thus, by virtue of their hire dates, the FMRs did not bring the same equities as the more senior PEX pilots. Contrary to the CAL and FAL Committees' proposals, the FMRs' seniority should be determined by when they were hired by their ancestral carrier, as was the case with all the other pre-integration pilots. They were part of the same package of pilots and equipment that Continental began holding out to the public as its own on February 1, 1987.

The financial condition of the carriers shows that the CAL pilots had positive promotional expectations at the time of the acquisition, while the PEX pilots had no objective promotional expectations. Continental was setting traffic and financial records from 1984 until the PEX acquisition. CAL's 1983 bankruptcy was merely done to reorganize its financial position, and it was a

highly successful endeavor. Continental did not need PEX to survive or to attain its present size. It was on a strong

growth trend from 1984 to 1986 in a market with no shortage of aircraft in 1986, especially B-727s, B-737s and B-747s – the types of planes used by PEX. Continental was already developing its Newark hub at that time and, even without PEX, probably would have done so. There was no shortage of pilots in 1986. The Company's current bankruptcy, filed for on December 3, 1990 to gain relief from the interest expense inherited largely from PEX in 1987, is irrelevant to these proceedings. PEX was a failed airline by September 1986, and it had been "dying" for at least a year prior. Its failure was due to several causes. The "no frills" concept was no longer viable. Over-expansion had pushed PEX into the wrong cities and into competition with major carriers that had superior technology. Its rapid expansion in late 1984 and 1985 increased operating and interest expense costs and operational problems. The most pervasive reason why PEX could not compete with the major carriers was its lack of a sophisticated computer reservation system, which the majors used to underprice PEX. In addition to internal expansion, PEX mistakenly tried to grow by acquisitions. PEX lacked a traditional management and support infrastructure. Finally, it antagonized travel agents through low commissions, telephone delays and unanswered calls.

94

The proof of PEX's failure takes several forms. At the time of the acquisition, PEX had neither the equity nor the cash to operate. Its cash balances fell steadily and dramatically from late 1984 on. By June 23, 1986, when PEX announced it was for sale, the company was "technically insolvent" because it was out of cash and had an inability pay bills. PEX's cash flow is not a meaningful indicator, and even if it were, the trend at PEX as very negative in all four quarters of 1986. Although PEX grew from 1981 to 1985, it did not put in a good financial performance, as properly measured by net income. Over its six-year existence, it lost $214.8 million. The Company

never obtained net cash from operations, but rather from financings. By July 1986, the financial markets were completely shut to PEX. By September 1986, there was n remaining significant equity in its collateral on which additional financing could or would be based. Another indication of PEX's poor financial shape was its general retrenchment, including downsizing of its fleet. The B-747s were high cost, money-losing planes for PEX, and the market for them was soft in mid 1986. The August 1986 Business Plan also contemplated downsizing the B-727 fleet by eight planes. The result of the fleet downsizing was a corollary cancellation of service at five cities, with five more on the immediate "watch" list and an overall 14 percent fewer block hours. On October 16, 1986, PEX sold all of its interest in another six B-727s

to NYA, and the planes left PEX's property on November 15, 1986. In sum, on September 15, 1986, PEX could only count 71 planes in its fleet, and on November 15, it had only 65 planes left, and one B-747 on order that it could not afford to take delivery of, but which the Company credited to the PEX pilots in its proposal. Because of PEX's low fare strategy, to be profitable it needed exceedingly high load factors, which it could not come close to meeting in September 1986. Long before the announcement of the TAC-PEI deal, PEX had experienced a steady decline in traffic and consumer loyalty. It also was too dependent upon leisure travelers, and it did not have a business traveler following which it belatedly attempted to pursue. PEX was ready for liquidation in September 1986, because its operating philosophy and industry changes had foreclosed the possibility of reorganization. At the time of its failure, PEX had already pushed its operating cost to an industry low level.

The September 15 agreement did not give TAC control over PEX before December 30, 1986, and as a result the

PEX pilots must take responsibility for the events at PEX from September 15 until December 30, 1986. There was never any assurance that the deal would be consummated, and even if consummated, whether TAC would leave PEX as a stand-alone subsidiary or merge it with Eastern or Continental. During the period from September 15 to December 30, TAC and CAL avoided even the appearance of control over PEX.

96

With regard to the six B-727s that were transferred to NYA (and later CAL), the planes were clearly TAC's, and any flying done on them by PEX pilots is irrelevant. The September 15, 1986 Acquisition Agreement permitted TAC to have its designee purchase 12 B-727s, an aspect of the deal that was not conditioned on consummation of the rest of the deal. The first six planes were sold to NYA, and because PEX needed them to fly its fall schedule and survive, NYA allowed them to stay at PEX until November 15, after which they became part of Continental. TAC never took delivery of the other six B-727s, because PEX had so few uncollateralized assets by October 1986 that it could not give TAC the sufficient security, and further because their loss would adversely affect PEX's system.

The September 15 announcement of TAC's acquisition helped PEX's traffic and boosted consumer, shareholder and employee confidence. The announcements that really hurt PEX in 1986 were its announced decision on June 23 to search for a buyer and the announcement on August 28 that it had put Frontier into bankruptcy.

PEX had no alternatives other than Texas Air. Massive efforts to find another buyer had failed. No one else was ever interested enough to make an offer. None of the unionized carriers wanted to acquire PEX, since it was in their economic best interest to see it disappear. America West never made an offer to acquire PEX, and it was not

interested in doing so. A "turnaround plan" would

not have saved PEX, and no such plan had actually been formulated.

Continental's determination that the PEX pilots were entitled to 295 captain positions was fair and equitable. Contrary to the claim by the PEX Committee, Continental does not staff at the levels required in the peak flying months. Rather, it determines the number of crews required to meet its flight schedule on each of the months expected to be covered by a system bid, examines the high and low points, and picks a staffing level in between. The PEX staffing determination was strictly a business decision, made in the ordinary course of business by the management official responsible for making such decisions. Because Continental was the acquiring carrier, its business judgment, rather than that of PEX, governed the determination of the variables in the staffing equation (block hours and pilot utilization rate). Continental made the PEX staffing determination in late February or early March 1987, using the method by which its own staffing requirements are determined. The Company had no obligation, legal or otherwise, to use the peak month flying hours in 1987 for PEX aircraft. Additionally, operating forecasts and the resulting staffing projections are constantly revised, and the Company's PEX staffing determination in March 1987 was fair and equitable under the circumstances existing at the time. The block hours used were fair and equitable, and they produced the same number

of captain positions that PEX would have needed under its Business Plan had it been able to survive. Moreover, the Official Airline Guide for the period October 1986 through January 1987 shows that PEX had projected a significant

reduction in block hours either consistent with or below those contained in the Business Plan. In this regard, the unequivocal testimony of the CAL manager in charge of staffing was that CAL had no control over PEX's staffing during the fall of 1986. The pilot utilization rate applied in the PEX staffing determination was fair and equitable. The figures were obtained from the PEX head of manpower planning in order to confirm consistency with the Company's figures for the entire pilot population including management pilots. Because the utilization rates were essentially the same at both airlines, the PEX rate was used. Block hour utilization always contains management pilots. Even assuming that the PEX utilization rate did not account for management, Continental was under no obligation to adopt PEX's management structure; and CAL's own figure for pilot managers was only five percent, thus yielding only 13 more captain positions than were credited for the PEX pilots.

The respective pilot committees' staffing analyses only reinforce the conclusion that the staffing determination with regard to PEX was fair and equitable. The CAL Committee's staffing analysis is flawed because it is not, on balance, a true staffing analysis based on a

forecast of requirements during a future month or bid period. The FAL Committee's staffing analysis, like the CAL Committee's theory, is based on the actual PEX requirements during December 1986. Moreover, it is based on the number of captains PEX required under PEX's schedule, as opposed to the essence of the PEX staffing determination – the number of captains CAL required under CAL's schedule. The FAL proposal is further flawed with respect to the B-747s, because it proceeded from the false premise that by including the flying time generated by five 747s in System Bid 87-1, CAL was excluding those aircraft from the PEX operation. The effective date of System Bid

87-1 was December 15, 1987. Thus, the fact that the bid included B-747 flying time in the Pacific did not mean that CAL was intending, at the time the PEX staffing determination was made, not to utilize those aircraft in the CAL-PEX operation during 1987. The PEX Committee's staffing analysis is based on a "crews per aircraft ratio" method that is an imprecise and unreliable staffing method. It is in fact a fiction because the crews per aircraft ratio is the result of the block hours analysis, not its functional equivalent. By definition, the ratio changes any time the variables in the staffing equation – block hour sand pilot utilization – change.

System Bid 87-1 was not issued in anticipation of the Company list at issue. It was posted on January 27, 1987, approximately six weeks before the Company decided

to construct it's own integrated list. The bid was necessary to accommodate the projected growth of CAL throughout the remainder of 1987. On September 12, 1986, the CAL pilots were anticipating the arrival of 104 aircraft on order and option. The timing of Bid 87-1 was a business decision designed to accomplish the training required by the influx of new aircraft, not to upgrade CAL pilots to captain positions at the expense of PEX pilots.

The Company properly determined the PEX captain cut-off on the integrated list from the only available PEX list. That the Company's list "split" a class of PEX captains does not demonstrate unfairness. The 295th PEX pilot had moved up to number 288 by March 12, 1987, due to nominal attrition among the PEX pilots. The 288 number is only one number less than was produced under the Company's staffing analysis of PEX's requirements. The six additional PEX captaincies were given at the request of PEX management and not on the basis of staffing. Therefore, PEX is not entitled to any additional captaincies based on the Company's analysis and construction of the seniority list.

Promotional expectations of the pilot groups should be considered as a September 15, 1986. However, there is no basis for using that date for all other purposes. Texas Air had no control over PEX before the acquisition was consummated on December 30, 1986. Thus, the equities of any aircraft or other assets attributable to PEX should

be measured as of that date, if they become a factor in constructing the integrated list. Indeed, the Company gave PEX credit for all 66 aircraft in the PEX fleet as of December 30, 1986, even though TAC had paid for the 66th plan – the B-747 that PEX could not afford. As for the number of pilots used in constructing the list, that is to be measured as of March 12, 1987, which is the date used by the Company in constructing its list. Moreover, the District Court ruled that only those pilots still working for PEX on March 12, 1987 are part of the class.

The PEX pilots are not entitled to special consideration because of the Newark hub, Terminal C or other non-fleet assets. Those assets, even if they are considered within the context of career expectations, do not justify giving the PEX pilots any special consideration that will counterbalance their extremely negative job prospects before the acquisition. This is so because any consideration of the benefits to Continental from the assets must also weigh the harm. The evidence is overwhelming that PEX saddled with enormous costs in terms of loss of customer goodwill and soaring consumer complaint rates resulting from the difficulties incurred in trying to absorb the chaotic PEX operation. There were also other unexpected surprises, such as onerous contracts that Continental had to assume. There were increased debt expenses, capital improvements to PEX's fleet and facilities, and lease payments on unproductive space. In

contrast, the merger of Frontier's operations went extremely well, because of the experience of the FAL employees and a traditional management structure in operating a full service airline. Many of the operational and financial burdens thrust upon Continental were attributable to PEX's practice of contracting out traditional or core services, and under cross-utilization, assigning inexperienced employees to handle the contracting out function.

Continental was successfully building a Newark hub even before the acquisition of PEX, and any airline was permitted to use the international arrivals gate at Terminal C. There also were no high density airport slot constraints at Newark, and CAL and NYA had existing market presence in the New York City area. Newark is not CAL's largest hub, and is only part of a large, worldwide operation.

The PEX pilots should not receive special credit for Terminal C. TAC did not acquire Terminal C through PEX. Indeed, PEX would have lost its lease to Terminal C. The lease held by PEX for most of 1986 and 1987 was commercially worthless. PEX did not bring a 25-year lease to the merger negotiations with CAL. The merger was not motivated by Terminal C, and TAC obtained the lease on its own. There was an absolute prohibition against PEX subleasing Terminal C without the Port Authority's written consent. Even after PEX had been combined with CAL for marketing purposes on February 1, 1987, the Port Authority refused

to guarantee that CAL would be allowed to take over PEX's lease. In fact, the Port Authority could have assigned the lease to any other airline on 30 days notice to PEX. The assignment was effective August 15, 1987, the first time that Continental had a contractual interest in Terminal C and control of the lease. PEX should not get credit for designing the terminal. Only two-thirds of the building, domestic concourses C-1 and C-2, was actually covered by the lease,

and the structural shell of the departures level main building was erected by the Port Authority in 1971. Nor was the international arrivals gate part of the lease. PEX never completed its design for the terminal. The work that it did complete was not designed for the efficient functioning of a traditional carrier. Numerous functional aspects of the terminal had to be corrected before CAL could occupy it. Indeed, since PEX itself was aspiring to become more traditional, it too would have had to alter Terminal C had it been able to survive. The largest design deficiency in Terminal C was the baggage system and the concomitant design problems it dictated for the rest of the terminal. As a non-traditional carrier, PEX did not have the same need as most normal carriers for baggage drop-off at curbside and at the departures level ticketing counters. Consequently, PEX's system could not handle the volume of baggage attendant to a major airline like Continental. The addition of the necessary 50 additional ticket counters

along the front of the "window wall" also had the unfortunate side effect of practically eliminating the value of the passenger display flight system, because it is now very difficult to read the information on those signs; but moving them would be cost-prohibitive and would eliminate their intended value of providing flight information near the ticket counters. The baggage claims carousells were only marginally adequate for CAL. The baggage system was not fast enough to handle traffic during CAL's peak departure times, and it could not handle oversized bags and skis, which have to be either driven or carried by hand to the planes. CAL paid $577,619 just to install an oversized baggage system and $5 million in total changes to the main baggage system. In installing a direct feed from the apron level to the baggage claims carousels, Gate 70 (a prime, close-in gate) has been lost until 1993 or 1994, at which time it will cost CAL $12 to $15 million to fix the problem. PEX's design of

Terminal C also posed problems for CAL with respect to the number of wide-body gates and jetways. Another significant design deficiency, which cost CAL about $4 million to remedy, was the failure of PEX to provide office space for a traditional airline operation. These design deficiencies must be taken into account because Terminal C was not adequate for any traditional carrier. CAL paid for the construction of the terminal, and PEX had no investment in it. PEX's design was no more than 50 to 60 percent constructed

by October 1986. Terminal C and the North Terminal Annex project were finally closed out in October 1990 at a cost of about $280 million, of which the Port Authority had financed $225 million and CAL had financed $55 million. In addition, CAL's lease required that it invest $25 million in Terminal C for required items which would have been required by any traditional airline. CAL also will repay the Port Authority for the $225 million financing over the 25 year term of the new lease. In August 1986, PEX had built only 30 percent of the current terminal, and by August 1987, when CAL assumed the lease, only about 56 percent of the current terminal had been constructed. In short, Terminal C as it stands today owes its existence to Continental; especially the interior seen by the traveling public and the functional elements of the building that serve the public.

The PEX pilots should not receive special credit for other assets acquired along with PEX. These facilities were not "turnkey" in nature, as demonstrated by the large amount of work that was required for CAL to absorb them. Moreover, other items were not useful to CAL, and others still were not even assets of PEX. When compared to the rest of CAL's facilities throughout its vast system, the facilities contributed by PEX are not the key to Continental's future growth. The other Newark facilities, as well as Terminal C, were inadequate. These included: the flight

kitchen and food operations; the

106

Hangar 55 aircraft maintenance facility which has cost CAL $10 million and will require further expenditures; the cargo facility, a number of infrastructure deficiencies at Newark Airport, such as inadequate road frontage and parking; the unproductive North Terminal which CAL assumed under PEX's lease with the Port Authority; and two administrative buildings across from Newark Airport – the Haynes Avenue Building and International Plaza – which CAL assumed under PEX leases and which have imposed significant costs on CAL from unproductive space. Continental also inherited PEX's lease obligations on facilities at other airports, despite the fact that CAL did not have a use for all of them. Space at seven such airports has been unproductive for CAL at a combined cost of over $1.8 million through the end of the respective lease terms. Most of the PEX outstations were closed and PEX operations relocated to the better facilities of TAC subsidiaries. PEX's ground handling facilities throughout the country were in poor physical repair, a problem that cost CAL over $15 million to rectify at the outstations, not including Newark. One hundred and sixty four of the high density airport slots for which PEX claims credit were commuter slots and could not be used by regular air carriers. PEX held only 35 slots, 14 at Washington National and 21 at Chicago. The combined CAL-NYA had about five times as many slots as PEX. The PEX Committee cannot remedy this imbalance by claiming credit for the Britt and PBA

107

commuter slots which were not PEX slots, and in any event were less valuable than jet slots. Because TAC acquired its interest in PEX's slots at Washington National and Chicago on September 15, 1986 as collateral for the first $10 million

cash infusion, TAC held an interest in the slots and could have seized them when PEX defaulted on the loan.

Domestic routes are not an issue in this arbitration, because a domestic certificate has no market value under deregulation where a carrier can fly into whatever domestic cities it wants to pursue. Of the three PEX international destinations, only the London route had even nominal value when it was received from PEX. The Brussels and Montreal routes had no value. The London route was losing money for PEX and was not worth very much without a great deal of marketing efforts. Although PEX had proposed flying to certain other cities as charters, those never took place. PEX had no Pacific flying. Regularly scheduled service from Los Angeles to Honolulu did not commence until December 12, 1986. Even then, the Honolulu flying was added only because PEX could not attract enough passengers on its own B-747 routes.

SAS did not link up with TAC in October 1988 as a collateral benefit from the PEX acquisition. PEX and SAS were the two extremes in providing passenger service, with SAS at the high end. SAS first approached Eastern in 1983 to discuss a link-up at John F. Kennedy International

Airport (JFK). At the same time the TAC-SAS deal was signed, SAS planned to operate three daily flights from JFK and only one from Newark. Moreover, to the extend that SAS was interested in the Newark hub, that was something that CAL could have provided without PEX.

The Company acted in good faith in imposing the seniority list. It received input from both pilot groups and acted in the best interest of all the pilots. When the PEX pilots were offered a "New York Air-type" expedited dispute resolution structure for the seniority integration, they rejected it. The PEX Committee counter-proposed considerable significant deletions and purported to mandate an operational integration of PEX and Continental, rather

than leave that decision to management. It deleted the notion of balancing the "benefits" and "losses" fairly between the two pilot groups. All references to the traditional arbitral factors, as set forth in the NYA procedures, had been deleted. The PEX Committee did not want the Company to assist the pilot groups with the payment of outside counsel's fees. One of the conditions inserted by the PEX Committee was that pilots "from both PEX and CAL will be protected in their status and category". At this point, the Company started to believe that it would not be possible to do a NYA-type expedited arbitration with the PEX pilots. The Company conveyed its position that the PEX counter-proposal was not satisfactory. The exchange of proposals was not the

only communication with PEX pilots regarding seniority integration. Both before and after the consummation of the merger, the Company talked to the PEX Committee and management pilots to get their input regarding integration. Such discussions took place as early as November 1986. On January 6, 1987, PEX's General Counsel met with the PEX Committee and its counsel to discuss seniority integration procedures and conditions. On February 12, 1987, CAL's Vice President of Flight Operations met with a PEX senior pilot who then communicated their discussions to the PEX Committee chairmen. The PEX Committee maintained its position, as stated above, it its counter-proposal. The PEX Committee also stated that it did not want to wait until the FAL arbitration was completed. These positions were unacceptable to the Company, especially the demand to start the arbitration immediately, because it could not have handled two arbitrations at once. On March 10, 1987, the Company met with the CAL and PEX pilot committees to consider their input as to whether management should construct its own list or whether the issue should be submitted to an arbitrator. One consideration was that the

Company was planning to hire 1,000 new pilots in 1987 to operate many new planes coming from Boeing and McDonnell Douglas. The Company simply could not operate all these new aircraft without a new system bid, and expediting the list gave the PEX pilots an opportunity they otherwise might have missed to

bid on this new equipment. Given the past tensions and operational problems, along with the process sought by the PEX Committee, it was determined that an arbitration would be more harmful at that time. On March 12, 1987, PEX and CAL entered into the agreement that outlined the concept for the Company's list. The agreement was signed for PEX by Captain Frederick Abbott. Despite the affirmation by Arbitrator Nicolau in taking the same approach as the Company had taken in its conditional March 1987 list, the Company still endeavored to solicit the input of the two pilot groups regarding the contingent CAL-PEX list by scheduling a meeting for June 30, 1987. The two pilot committees were unable to reach agreement at that time. Given the history and deliberation behind the evolution of the Company's list, it is impossible to say that it was imposed as an arbitrary and punitive act.

In this case, there can be no meaningful comparison of the relative compensation benefits and quality of work life of the CAL and PEX In light of the overwhelming evidence that PEX was ready to go out of business, any benefits received at Continental are superior to the alternative for the former PEX pilots (and the former FAL pilots). However, any fair and equitable list has to weigh benefits granted or concessions required as a direct result of the acquisition itself, since such items are implicitly part of the purchase price. Thus, as stated, considerations should include the PEX and

FAL pilots' continued employment; the debt forgiveness /income tax payment program for the PEX pilots versus the FAL pilots' waiver of claims against the Company' the PEX pilots' gaining of a retirement fund for the first time versus the FAL pilots' loss of their Frontier retirement plan; the PEX pilots' keeping longevity from PEX for benefits purposes versus the FAL pilots' loss of longevity for the same; and the benefit both the FAL and PEX pilots received from joining a larger system with more routes, more types of equipment and more domiciles. All of these facts are important considerations in balancing the equities as between the PEX and FAL pilots.

The proceedings in the District Court are irrelevant to this hearing. The Company wanted to avoid a protracted and divisive arbitration, and it asserted its position in good faith. When the PEX pilots required that the Court impose sanctions of the Company for defending against their claims, the Company fully justified its position and the sanctions were denied.

The evidence has shown the following basic, relevant facts. From 1984 to 1986, CAL was setting traffic and financial records, and its pilots had strong and growing promotional expectations and job prospects. It was well posed for future growth in Newark and elsewhere, and it did not need PEX to expand. From 1984 to 1986, PEX became financially weaker and ultimately was subject to

bankruptcy and imminent liquidation. The promotional expectations of its pilots were eroding, and by September 15, 1986, its pilots faced the certainty of no job prospects. PEX was financially and operationally more like its sister airline, FAL, than either was like CAL in the years immediately preceding the merger. While the FAL pilots had more longevity than the PEX pilots, the FAL pilots gave up more in the Acquisition Agreement than the PEX pilots by every measure. The Company list considers the above factors and

balances them, such that the career expectations of the pilots from the growing carrier (CAL) are preserved. The pilots from the failed carriers (PEX and FAL) are not relegated to the bottom of the seniority list but instead are given credit for their contributions to the combined entity in a way that does not overly encroach on the pre-acquisition job prospects of the pilots from the growing carrier. The Company list is based on the staffing method CAL utilizes in the ordinary course of business and was applied to each of the pilot groups in an evenhanded manner. Each of the pilot committee proposals seeks to advance the career expectations of its constituents at the expense of the other pilot groups, and each fails to give full credit to pilots from the competing pilot groups for their contributions to the combined entity.

The arbitral mandate in integrating airline seniority lists is to preserve, insofar as possible, the

pre-integration career expectations of the respective pilot groups. The single most important factor to be considered in this analysis is the pre-integration economic health of the respective carriers, since this is what dictates their future career expectations.

The Company's list is by far the best proposal to accomplish the District Court's mandate. The "fair and equitable" standard does not require a "perfect" seniority list. Rather, the list must be "fair". Even assuming, however, one of the pilot committee proposals were also fair, arbitral precedent requires that so long as the Company's compromise list is also fair overall, the argument for any change would have to be highly persuasive. Nor, in this turbulent economic time in the airline industry, would a massive alternation of the presently constituted list (at the cost of millions of dollars) be in the best interest of future, secure jobs for all pilots – including PEX, FAL and CAL.

Discussion and Findings

The most striking aspect of this dispute has been the intensity of effort and commitment of the pilot committees and counsel in presenting their positions. The divergent histories of the three airlines provided sufficient justification for each pilot group to view its interests as paramount. Frontier had a long and proud record as a quality carrier which rapidly tumbled under

PEI's control. Continental weathered intense labor struggles and difficult financial obstacles, and it emerged as a major carrier through astute financial management and employee efforts. People Express introduced revolutionary concepts in air travel and employee involvement during its nova-like existence.

These sharp differences converged in 1987, when the Company proposed an expedited dispute resolution procedure for the CAL-PEX pilot seniority integration after having spent significant time and resources in the NYA and FAL arbitrations. The PEX pilots, however, proposed a more conventional process. The parties were unable to agree on the ground rules, and the PEX Committee filed suit on April, 1978 to enforce its rights under the LPA.

The District Court's Order compels the integration of the CAL, PEX and FAL pilot seniority lists. This mandate necessarily requires a comparative analysis of the equities brought to the merged carrier by the three pilot groups.

The FAL Committee's position, as stated above, sets forth the equities brought to the merger by the FAL pilots. The record reflects that after 1985 these pilots had made heavy personal sacrifices in their attempts to keep Frontier flying. When their efforts failed, the pilots chose to preserve their jobs through their agreement to the JPA and its Sideletter No. 2 which established the guidelines for the

arbitration.

The JPA's Sideletter No. 2 required Arbitrator Nicolau to "take special notice of (a) the non-operating status of Frontier Airlines immediately prior to the date of this Agreement and the limited employment prospects for Frontier employees resulting therefrom, and (b) the fact that Frontier pilots, aircraft and assets are expected to enhance Continental's competitive position". The Sideletter further bound the arbitrator " . . . to ensure that there is no dilution or adverse impact on the promotional expectations (for Captain or First Officer status without regard to equipment type) of either (i) those Continental Airlines (including New York Air) pilots in active service on the date this Agreement is executed (based on all aircraft in service, or on firm order or option to Continental, New York Air or TAC as of September 12, 1986 . . ."

In effect, the JPA and its Sideletter No. 2 defined the respective promotional expectations of the FAL and CAL pilots in a manner which greatly restricted the FAL pilots in pressing for a full measure of recognition commensurate with their contributions to the merged carrier, under established arbitral standards of fairness and equity. Arbitrator Nicolau determined that he was required to give greater weight to the non-operating status of Frontier and the resulting limited employment prospects of the FAL pilots than the expected enhancement f Continental's competitive position through the acquisition of Frontier's

assets. Moreover, he found that the Sideletter protected the promotional expectations of the first officers as defined by Continental aircraft on order or option on September 12, 1986.

The LPA and the Order, however, contain no requirement to take special notice of the particular status of any of the carriers. Nor do they require the Arbitrator to ensure that the promotional expectations of a particular pilot group receive special protection. Rather, the LPA and the Order provide only fro a "fair and equitable integration" under which, the Order states, "[t]he parties are free to urge the neutral to consider any factor".

These critical differences between the arbitral charters of the JPA and the LPA require my analysis to focus primarily on the relative equities of the CAL and PEX pilots. To do otherwise would place the PEX pilots in the same unequal position as the FAL pilots in the CAL-FAL arbitration. For these reasons, I find that while the FAL pilots' equities must be weighed in creating a merged list which integrates the PEX pilots, the current placement of the FAL pilots on the seniority lists is one of many factors to be considered in balancing the pilot groups' equities. I have also noted that in September 1986, TAC had paid nearly 25 percent more for Frontier's assets than for all of PEI's holding which included PEX, Britt and PBA.

In constructing a fair and equitable list, I have

considered the placement of the NYA pilots on the CAL list though an arbitration award dated December 18, 1986 following hearings held from September 2 to 12, 1986. While the NYA pilots are not a discrete group in this proceeding, the timing of their airlines start up, their seniority list integration, the merger of the operations of NYA and CAL, and the CAL-PEX marketing agreement on February 1, 1987 provide other benchmarks from which the myriad number of facts and equities in this case can be weighed. The NYA captains were ratioed with a group of CAL captains and first officers following the first 651 positions on the CAL seniority list. In constructing the list in the present case, I have noted that the NYA pilots had cast

their fortunes with TAC, and in this way they shared a common bond with the CAL pilots prior to the merger. I have also considered the contributions of NYA and PEX to the merger carrier as well as their relative financial health in September 1986, without regard to whether TAC and PEI – which appear to have been committed to ensuring the success of their subsidiaries – provided a source of funding.

I find that the most compelling reason for changing the existing list arises out of the Company's basic determination to compare the equities of the PEX and FAL pilots to the exclusion of other important factors – not the least of which, as stated, was the FAL pilots' placement on the list as a result of the JPA's conditions.

Other factors which support a change in the company's list center on the contributions of People Express to the merged carrier. On the other hand, the requirement for an extreme change in the existing list is offset to some extent by the absence in the PEX Committee's proposal of any consideration of preserving the career expectations of the pilot groups as they existed prior to the merger.

Economic viability of the respective carriers is a relevant consideration in assessing the promotional expectations of the competing pilot groups. The economics of the airline industry following deregulation in 1978 forced carriers to achieve sufficient size to continue to exist as independent entities which could compete successfully in a market regulated industry with acute price competition. Deregulation made it possible for two-thirds of the new entrants to fail – a condition which would not have occurred in the government regulated market of prior years. These realities dictate that a carrier's financial condition as well as the pilot jobs and other equities brought to the merged carrier be considered in constructing a fair and equitable integrated list.

In the present case, several overriding considerations required a rejection of the PEX Committee's proposal based on a status and category ratio approach. The change of People Express surviving its grave financial difficulties in September 1986 was at best a very long shot, and at worst a foregone conclusion of failure. As a result of

excess capacity, the jobs associated with PEX's B-747 flying had been greatly reduced. In this regard, I find unpersuasive PEX's assertion that the B-747s would have been gainfully utilized in charter flying. Additionally, wide-body flying at both People Express and Continental was not and is not now paid at a premium rate. The mystique factor in B-747 flying, which is a valid consideration, does not by itself serve to justify a status and category method of integration. This is especially true in this case where such an approach would place the senior PEX pilots, hired after 1980, among the senior CAL pilots hired in the 1950s and 1960s.

During a significant portion of the hearings, the PEX Committee took on the herculean burden of demonstrating that People Express could have weathered its financial storms. While it is true that the airline was operating on September 15, 1986, the voluminous evidence in the record concerning its financial condition indicates otherwise. The testimony of top level PEX officials who attended PEX board meetings at the time of the merger and thereafter adds dimension and support to the documentary evidence. PEX's financial circumstances in 1986 were far more severe than a temporary economic setback or wide swing in performance which can occur at any time in the volatile environment of the airline industry. For this reason, a comparative analysis of the four airlines' financial performance during the five years

preceding the merger is of little relevance to a review of the promotional prospects of the pilot groups in September 1986. Indeed, a review of PEX's performance in 1985 reveals that signs of deterioration in its economic health were present when its capacity had outstripped its demand and major carriers had begun to effectively compete against its low cost strategy with their sophisticated, computerized yield management systems and full service alternatives. In early 1986, PEX lacked financial resources, marketing capability and credibility with travel agents. By the summer of 1986, People Express had fallen into an uncontrollable tailspin. If the TAC-PEI merger had not been consummated, the virtually certain alternative was bankruptcy and liquidation.

The three other airlines relevant to this integration also had problems, ranging from the non-operating status of Frontier to the debt-laden burden of Continental to the continuing need to New York Air to be supported by TAC. Except for Frontier, however, People Express was by far the weakest of the sister airlines in September 1986.

There is no convincing evidence that TAC or CAL controlled PEX's operations following the merger and prior to its approval by the PEX shareholders on December 29, 1986. Until that date, the consummation of the merger was far from a certainty. Nor did the merger hinder PEX's ability to operate during this period. To the contrary, the credible evidence indicates that TAC's

cash infusions totaling $107 million and the affiliation with Continental were positive factors in maintaining PEX's viability until February 1, 1987, when both CAL and PEX flight services were marketed under the Continental name.

I find that the Company has fairly calculated the total number of pilot positions brought to the merged carrier by PEX and required by Continental, as described above. Sixty-six aircraft was a reasonable reflection of the PEX fleet operating out of Newark in February or March of 1987, or in

mid-September 1986 after PEX had agreed to release 13 aircraft from its fleet of 79. The block hours used in the Company's staffing determination were based on a realistic projection of the flying schedule for the PEX fleet made in February-March 1987, as opposed to using a September 1986 date which did not reflect the downsizing of the PEX fleet and the reduction of block hours under a proposed business plan prepared prior to the merger. The Company's approach is also preferable to those of the CAL and FAL Committees which use PEX's December 1986 flying, thus basing their determinations on a traditionally low volume month as opposed to the conventional staffing method based on projections of future flying.

After reviewing the compensation packages, other benefits and working conditions at Continental and People Express in September 1986, I find that for the purpose of

determining relative equities based on these factors, no significant differences existed. Both airlines paid salaries well below those at the major carriers. Even assuming that the PEX captains received a $12,000 pay increase in August 1985 and absorbed a $12,000 pay cut in order to align themselves with the CAL captains in November 1986 (as opposed to a pay cut based on internal considerations), when considered in the comparison of total pay, benefits and working conditions of both carriers in 1986, this difference does not tip the scales to support a finding that the PEX pilots had significantly greater equities in this area. PEX offered a unique mix of benefits, some of which were tied to the company's financial performance, while CAL provided a more traditional benefits package. Although the record reflects certain employee dissatisfactions at CAL in 1986 in the aftermath of its labor and financial problems, there also is persuasive evidence that PEX employees had been experiencing declining morale as the airline's fortunes turned downward. On balance, the People Express work

environment – with its unorthodox management structure and cross-utilization – presented stimulating challenges and exerted strong pressures on employees, in contrast to Continental's traditional management structure, conventional employment conditions and seniority based procedures.

The contributions of People Express to the merged carrier were substantial. All of the parties acknowledge

the highly motivated and dedicated PEX pilot workforce, many of whom were hired when the major airlines were not hiring, thus allowing PEX to recruit and select the best available pilots. People Express, with its non-union status and low cost market niche, presented a highly compatible fit for Continental and removed a competitor on its east coast routes. The PEX domestic and international route structures also complemented the CAL system, although PEX's international operations – other than the London route – appear to have had little value in 1986. The PEX slots as well require some note, but their value is reduced significantly because the great majority of them were commuter slots. The PEX aircraft, while older and requiring modification for meal service and conventional seating, were a substantial addition to the merged carrier's fleet and numbered almost as many planes as FAL and NYA combined had contributed. The PEX standardized B-747s added a new dimension to the merged fleet and substantially increased Continental's international wide-body capacity.* I also have accorded some credit to the PEX pilots for the Newark hub and the other facilities in and around Newark International Airport. In the absence of other airline interest, it was PEX's initial long range.

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* I recognize that the crediting of these aircraft to the PEX pilots works yet another hardship on the FAL pilots in that the CAL pilots had received credit for them in the CAL-FAL arbitration under the application of the required terms

and conditions in that case. However, as stated, the PEX pilots should not be burdened with those requirements.

124

vision that significantly contributed to the airport's growth and mobilized action on the Terminal C project. Today the Newark hub and its spokes are one of the main components in the Continental system which, due in some measure to PEX's routes and assets, has attained the critical mass required to compete in the airline industry. The fact that Continental had started building its Newark hub prior to the PEX acquisition and could have achieved its current mass without PEX reinforces the conclusion that PEX's contributions enabled Continental to fulfill its growth objectives.

In my view, however, the PEX contribution to the merged carrier can hardly be termed a highly efficient turnkey operation. The entire People Express operation – based on no frills, cross-utilization and unconventional management and organization structures – required extensive modification of, for example, baggage systems and ticket counters, prior to assimilation by a conventional carrier. Certainly, Terminal C was nowhere near completion in 1986, and the facility had to undergo massive design and construction changes to adapt it to the needs of a conventional carrier. The record contains vivid testimony describing examples of the horrendous problems and resulting lost business incurred at Newark Airport following the merger of PEX and CAL operations in early 1987 through the opening of Terminal C in late 1988 – a markedly different transition than occurred with the

125

integration of the FAL and NYA operations. The other facilities in and around Newark Airport also were not highly productive and have required significant expenditures b

Continental to maintain them or to meet onerous contract terms negotiated by People Express. The outstations generally appear to have been in a state of disrepair and provided little more than a presence at the locations. And it must be noted that the acquisition of People Express added a $434 million long term debt load to Continental's already huge obligations.

By most measures, the PEX pilots gained more than they gave up in the merger. They moved from an unconventional operation filled with great challenges and even greater uncertainties to a more traditional carrier with a decidedly more promising future. The PEX pilots significantly enhanced their crew base opportunities from one, Newark, to: Houston, Denver, Cleveland, Los Angeles, Honolulu, Seattle and Guam. The diversity of schedules for the PEX pilots also increased as a result of the merger. Perhaps most important to the PEX first officers and second officers, their promotional expectations vastly improved as a result of moving to a carrier with a captain contingent which would provide continual attrition over many years, unlike the bunched distribution of the relatively young work force at their start up carrier.

Before analyzing the specific competing equities of

the three pilot groups within the above framework of general findings and principles, the status of the FMRs must be addresses. At the time of their hiring at People Express the FMRs, with few exceptions, did not have the requisite experience for selection by the major airlines, including Continental. However, they were qualified to occupy the first officer seat at PEX. If the opportunity had been available, many of the FMRs would have flown as first officers on a B-727 after one year of service. Whether or not PEX had planned to send the FMRs to its commuter airlines for seasoning and experience, I find that Continental's determination to utilize this approach was reasonable and in

most cases consistent with its background and experience requirements for pilots.

The first group of the 651 senior CAL captains on the Company's list on September 15, 1986 – the date of the merger announcement – brought equities to the merged carrier that far outweighed those of the senior PEX pilots. The dates of hire of the CAL group range from 1951 to 1972 (after which there was no hiring until 1977), whereas the PEX group was hired in the 1980 to 1982 period. Continental contributed equipment and assets providing pilot job opportunities well beyond those brought by People Express. To integrate the senior CAL and PEX captains would constitute a windfall for the PEX group.

A break in the hiring dates of the CAL pilots occurs at number 652, held by a pilot hired in 1977.

Under the CAL-NYA seniority list award, a group of 168 senior NYA captains was integrated with a group of 856 junior CAL captains. Following that block are the Frontier captains.

My prior finding with regard to the Company's placement of the NYA and FAL captains on the seniority list establish the broad parameters for measuring the reasonable career expectations of the PEX captains. The upper limit is the number one NYA pilot. The lower end is the number one FAL pilot. The great majority of the block between those two pilots is comprised of CAL pilots who are the primary comparator in this dispute.

I have weighed the following considerations in determining the appropriate integration point for the PEX captains into this block. Although the placement of the NYA pilots serves to reinforce my finding that the Company's treatment of the PEX pilots was incorrect, it is clear that the NYA pilots' career expectations were significantly greater than those of the PEX pilots. And the CAL pilots harbored even greater career expectations than their TAC counterparts

at NYA. At the other extreme, the FAL pilots' career expectations, as measured by the JPA, had been virtually decimated, notwithstanding their long service with Frontier. In balancing these career expectations and the contributions of the four airlines to the merged carrier, I find that the assets brought by People Express require the PEX captains

to be slotted somewhat below the number one NYA captain and well above the number one FAL captain. Such a placement results in the PEX captains sharing the positions below the bottom one-third of the integrated NYA-CAL captain block above the FAL captains. Viewing all hard captain positions on the integrated list, the PEX captain ratio begins well into the bottom half of the hard captain group, thereby reflecting the superior career expectations of the CAL pilots. The exact placement of the PEX captains was determined by length of service, including the strike time of CAL pilots but excluding their furlough time. The number one PEX pilot was placed in a position reflecting his length of service within the block of captains ranging from the number one NYA captain through the junior CAL captain on Bid 87-1.

Due to the difference in the career expectations of the senior PEX and FAL captains, with the latter bearing the burdens attendant to the JPA and its Sideletter*, I find that the block of 162 senior FAL captains must follow the ratioed group described above. In effect, the senior FAL captains comprise the lower portion of the hard captain positions available under Bid 87-3.

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* Conversely, I find no persuasive basis to assess the PEX pilots for their management's flagrant breaches of the October 1985 contract with the Frontier pilots.

I further find that the equities of the senior FAL captains outweigh those of the former PEX captains. The dates of hire for these FAL pilots run from 1954 to 1968, as compared to 1983 for the PEX pilots. Assuming that the jobs of the former PEX captains could have been salvaged absent the merger, they would not have occupied a captain seat under any realistic projection of flying as a downsized carrier. Of course, the FAL captains were facing even more bleak prospects. However, they brought the opportunity for Continental to revive a true turnkey operation based in a conventional facility in Denver. Additionally, their decision to preserve their jobs through the JPA enabled the PEX pilots to take advantage of the benefits of the TAC-PEI merger in the absence of any other viable alternative available in late 1986. A balancing of these relative job prospects, dates of hire and contributions to the merged carrier, in my view, results in superior equities for the Frontier pilots.

The FAL Committee's proposals regarding pay protection and longevity credit for these Frontier captains and other former Frontier pilots must be denied. The District Court's Order requires that "the integrated list shall not alter or vary Continental's employment policy". I am not persuaded by the FAL Committee's argument that Continental's employment policy is broader than the policy set forth in its Pilot Employment Policy, which covers pay policy. Additionally, the Order provides that "FAL

may not assert a position inconsistent with . . . [the CAL-FAL] Arbitration Award but shall, for the purposes of this arbitration, be deemed bound by that award". In that award Arbitrator Nicolau clearly denied the frontier pilots' request for longevity credit and effectively denied their request for pay protection.

I have apportioned the middle, or first officer, segment of the list by applying the same principles as were used in

constructing the top, or captain, portion of the list. Adopting the Company's staffing determination for the PEX first officers, my intent was to ratio the PEX pilots in a manner reflecting their promotional expectations and the contributions of People Express to the merged carrier. The conceptual upper limit to begin their placement was at the top of the block of 299 CAL order and option pilots, which included NYA pilots. The lower limit for starting the PEX ratio was the number one pilot in the block of 1262 CAL, FAL and PEX first officers established under the Company's list.* Mr. Nicolau was required to integrate the FAL pilots in a manner which accounted for the promotional expectations of the 299 CAL pilots. Therefore, he began the ratio of Frontier pilots immediately below this block of order and option pilots.

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* The block of 1262 pilots contains a ratioed group of 177 FAL pilots (143 of whom were captains at Frontier) and 579 junior CAL pilots pursuant to the Nicolau Award. They are followed by the group of FAL and PEX pilots integrated by date of hire.

I have chosen to begin the ratio at the 120th CAL pilot in the order and option block. This point was arbitrarily selected within the above stated upper and lower limits to integrate the former PEX captains – based on their equities and diminished promotional expectations – into the CAL pilots above them and the Frontier pilots below them. I have noted that almost one-third of the PEX downgraded captains (17 of whom, it appears had not even checked out as captain by September 15, 1986) had captain qualified dates in 1986.

I find that the placement of the remaining 100 or so PEX first officers and second officers should not change. These pilots had no career prospects, let alone promotional expectations, even if People Express had survived as a downsized airline. Their placement on the seniority li[illegible]

among the junior Continental and Frontier pilots reflects this fact and the relative equities they brought to the merged carrier.

The Company's placement of the FMRs immediately following the first officers and ahead of the Continental pilots hired after January 1987 shall not be disturbed. The FMRs were part of the People Express pilot group which the airline brought to Continental. Although they did not have the minimum flight hour requirements under which Continental normally recruited new hires, they were qualified pilots. As such, their equities were superior to those of the Continental new hires who had no employment

relationship with the Company at the time of the TAC-PEI merger. Any requirement at People Express for the FMRs to have flown at a commuter line does not alter the balance of the equities between them and the CAL 1977 new hires, even considering that in 1986 these CAL pilots had more substantial flying experience than the FMRs.

The resolution of this dispute required 73 hearing days and produced 16,725 transcript pages, approximately 1,000 exhibits and post-hearing briefs exceeding 1,000 pages. Hopefully, the opportunity for each part to have fully presented its case will result in a unified Continental pilot group.

AWARD

The Integrated List

The Continental Pilot Seniority List shall be integrated as follows based on a constructive September 15, 1986 list:

1. The Continental list shall remain as is from R.O. Glau to R.R. Heckenliable.

2. Immediately after Heckenliable, former PEX pilots J.F. Barrall through J.C. Walton shall be ratioed with Continental pilots G.D. Schafer through J.N. Dole on a 1 to 2.01 basis, Schafer first.

3. Immediately after Walton, insert former FAL pilots A.B. Kendell through J.W. Albritton.

4. Immediately after Albritton, the Continental list continues with N.G. Correa through J.F. Banas.

5. Immediately after Banas, former PEX pilots D.M. Miller through A.R. Parkhurst shall be ratioed with Continental pilots F.J.

Buckley through A. Rusinowitz on a 1 to 2.346938 basis, Buckley first.

6. Immediately after Parkhurst, insert former PEX pilots D.L. Hill through J.A. Berry with former FAL pilots G.L. Sims through A.E. Jones on a date of hire basis.

7. Immediately after Jones, the list continues with former PEX pilots A.M. Samad through B.M. Morris.

8. Immediately after Morris, the Continental list continues with T.J. Kratt until it end.

Conditions and Restrictions

1. No Displacements. The implementation of the integrated list shall not result in the displacement of any pilot from a status currently held, or any pilot to whom a bid has been awarded or for whom training has commenced, all as of the date the integrated list is implemented (i.e., no partial or

total system flush). This provision applies only to the one time implementation of the integrated list and not to subsequent events, which shall be governed by normal operation of seniority as reflected on the integrated list.

2. No Changes in PEP. The integrated list shall not alter or vary Continental's employment policy.

3. No Change in Relative Seniority Within Pre-merger Groups. The integrated list shall not result in a change in the relative order of: (i) any PEX pilot vis-à-vis another PEX pilot; or (ii) any CAL or FAL pilot vis-à-vis another CAL or FAL pilot as integrated by Arbitrator Nicolau on June 15, 1987.

4. Implementation. The integrated list shall be implemented as soon as possible but not later than 60 days after the District Court's approval of this Award.

Resolution of Disputes

Any dispute regarding the interpretation, implementation, or application of this Award shall first be referred to a Dispute Resolution Committee consisting

of two Company representative and two Continental, two former People Express and two former Frontier pilots. In the event the Committee cannot agree, by majority vote in which the Company and at least one representative of each of the three pilot groups concurs, on a recommended resolution of the dispute, the Company or either the Continental pilot, People Express pilot, or Frontier pilot representatives may submit the dispute to arbitration before arbitrator Jerome Ross for final and binding resolution. For the limited purpose of resolving any such disputes, the undersigned retains jurisdiction unless the period of his unavailability

exceeds six months from the date the dispute is filed with the Company.

S/S: Jerome H. Ross
Arbitrator

Dated: August 13, 1991
McLean, Virginia

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 24th day of September, 1991

Joint Application of DELTA AIR LINES, INC. and EASTERN AIR LINES, INC. For approval of transfer of certificate under Section 401(h) (Buffalo, New York-Toronto, Canada)	Docket 47390

ORDER

By this order we approve the Joint Application of Delta Air Lines, Inc. ("Delta") and Eastern Air Lines, Inc. ("Eastern") for the transfer of that part of Eastern's certificate for Route 148 authorizing scheduled combination service between Buffalo, New York, and Toronto, Canada.

Background

On January 19, 1991, Eastern suspended all of its scheduled services. Consequently, on the same day Delta applied for and received an oral emergency exemption from the Department authorizing Delta to serve Eastern's Buffalo-Toronto route.[1] On January 22, 1991, Delta commenced service on the Buffalo-Toronto route.

On January 29,1991 Delta and Eastern filed a joint application for approval by the Department under section 401(h) of the Federal Aviation Act ("Act") for the transfer of Eastern's Buffalo-Toronto route authority. The application requests processing using expedited nonhearing procedures under Subpart Q

[1] *See*, Order 91-1-46.

of the Department's regulations and notes that the transfer does not require review by the Department of Justice under the Hart-Scott-Rodino Act. The joint applicants specifically requested that the Department transfer Eastern's route by issuing a new certificate to Delta and encompassing authority to be transferred for nonstop service between Buffalo and Toronto. In addition, the joint applicants requested that we amend Eastern's certificate for Route 148 to substitute the phrase "Akron-Canton, Ohio" for "Buffalo, New York" in the first paragraph so that it reads "[B]etween the terminal point Akron-Canton, Ohio, and the terminal point Toronto, Canada," and by deleting the phrase "Buffalo, N.Y." from condition eight (8).

On February 21, 1991, the joint applicants filed their first supplemental submission to the joint application and separate motions for confidential treatment of various documents under Rule 39 of the Department's Procedural Regulations. The supplemental submission noted, *inter alia*, that on February 5, 1991, Delta and Eastern agreed to amend the January 16, 1991 Asset Purchase Agreement. The amendments increased the purchase price of the assets, including the Buffalo-Toronto route, from $1.5 million to $3.1 million and revised the "Due Diligence Investigation" provision to allow (21) twenty-one days from the date of the initial Asset Purchase Agreement to conduct a due diligence investigation into the use and conditions of the assets. All

other provisions of the Asset Purchase Agreement remained unchanged.

In addition, Delta revised its proposal to provide for the use of MD-88 aircraft, with the capacity to carry 142 passengers, which it currently uses pursuant to the emergency exemption.[2] Delta's Fuel Consumption and Availability" exhibit was revised to reflect the use of the MD-88. The joint applicants also submitted a copy of the Eastern Bankruptcy Court Order dated February 11, 1991, approving the sale of the Buffalo-Toronto route and certain Eastern assets and leasehold interest for space and facilities in Terminal 1 at Lester B. Pearson Airport in Toronto, Canada. Finally, the applicants request expedited action on their application.

The Department served notice on March 15, 1991, that the application was complete and that answers to the joint application were due by March 25, 1991 and replies to the answers were due by March 29, 1991. No answers opposing the transaction were filed.

The Application

The point applicants pose four main arguments in support of transferring Eastern's Buffalo-Toronto route authority to Delta. First, route transfer

[2] Delta had proposed to use B-737 aircraft, which has the capacity to carry 107 passengers.

approval would benefit the traveling public by improving the service in the nonstop Buffalo-Toronto market and would preserve single-plane service between Atlanta and Toronto.

Second, Delta claims a long-standing desire to serve the

U.S./Toronto market.[3] Delta's service in the Toronto market as a result of the oral emergency exemptions[4] represents a new entry for Delta into the U.S.-Toronto market and provides a gateway by which it can serve the Atlanta-Toronto market.

Third, the route transfer would promote intragateway and intergateway competition in the U.S./Canada market. Specifically, Delta's entry into the Buffalo-Toronto market would provide intragateway U.S.-flag competition with USAir. Furthermore, Delta would increase intergateway competition in the U.S./Toronto market by linking its hub at Atlanta on a single-plane service basis and, thus, provide broad geographical coverage for travel throughout the United States to Toronto.

Finally, according to the joint applicants, the route transfer would not conflict with international aviation policy objectives because it would improve service to passengers, strengthen the competitive position of U.S. carriers, increase overall competition, and maximize the use of bilateral route rights in a limited-entry market.

The joint applicants also assert that they do not anticipate any labor issues arising from this transaction. Eastern employees will not be affected by the transfer because substantially all of them have been given notice of termination effective as of February 2, 1991. According to the joint applicants, neither this transaction nor this type of transaction has been the subject of recent collective bargaining between Eastern and a union representing Eastern employees, or Delta and a union representing Delta employees.

Decisional Standard

Section 401(h) of the Act provides that no certificate may be transferred unless the Department approves the transfer as being consistent with the public interest. The Department has adopted as its public interest standard in such cases a policy of allowing proposed transfers provided that they do not conflict

[3] Delta and Eastern have also filed a joint application for the transfer of Eastern's routes in the New York/Newark-Montreal/Ottawa and Pittsburgh-Toronto markets. By Order 91-8-1, the Department announced, *inter alia*, that it had tentatively decided to approve the Delta/Eastern application for these routes

[4] In addition to Buffalo-Toronto, Delta was awarded an emergency *pendente lite* exemption to serve the Pittsburgh-Toronto market.

with important international aviation policy objectives and are not otherwise inconsistent with the public interest.[5]

Section 401(h) was recently amended by Section 9127 of the Omnibus Budget Reconciliation Act of 1990 to require the Secretary to certify to House and Senate Committees that the transfer is consistent with the public interest, and to submit a report analyzing the impact of the transaction on the viability of the carrier applicants, competition in the domestic airline industry and the trade position of the United states in the international market. We have considered these issues in reaching this decision.

Application of the Standard

The proposed transaction warrants approval under the decisional standard. No party has opposed the transfer. Accordingly, we will issue a final order transferring Continental/Eastern's certificate authority for the specified portion of Route 148 to Delta. In addition, we will amend

Continental/Eastern's certificate for Route 148 by substituting the phrase "New York, N.Y.-Newark, N.J." for "Buffalo, New York" in the first paragraph and by deleting the phrase "Buffalo, N.Y." from condition eight (8). We have decided to use New York, rather than Akron-Canton as requested by the applicants because New York-Newark is an active route and Akron-Canton is not. In accordance with our normal practice with respect to authority for limited-entry markets, we will limit the duration of such transferred authority to five years under section 401(d)(8)[6].

In additional, the approval of this transfer is in the public interest because it will have a positive effect on the viability of Delta by providing it with the opportunity to increase passenger revenues for the Atlanta-Buffalo-Toronto market. The transfer should have no impact on Eastern's viability, since it is in liquidation status and is not operating as a viable carrier. In any case, the transfer will provide additional funds to Eastern's estate to, *inter alia*, meet its payroll expenses to maintenance personnel who will continue to service Eastern's fleet and to management personnel who will be effectuating termination of Eastern's services.[7]

Furthermore, the transfer will promote domestic and international competition. Specifically, under the U.S.-Canada air Services Agreement, two U.S. carriers are authorized to provide nonstop service in the Buffalo-

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[5] *See e.g., Amercian-Eastern-Continental Transfer Case,* Order 90-4-11, April 6, 1990, at 7-8.

[6] *See, American-TWA Route Transfer,* Order 91-3-28, at p.19 and *Pan American-United Route Transfer,* Order 91-2-5, at p.18.

[7] Joint Application of Eastern Air Lines, Inc. and Delta Air Lines, Inc. (Joint Application) at 2-3.

Toronto market. If we do not approve the transfer of this route to Delta, given Eastern's cessation of service, there will

be only one U.S. carrier, USAir, in this market. Delta's maintenance of Eastern's Buffalo-Toronto nonstop and Atlanta-Toronto one-stop service will serve as a disciplining force to USAir. Thus approval of the transfer will enhance the level of competition in the domestic airline industry by maintaining competitive U.S. carrier service in this significant transborder market.[8] The transfer would also maximize bilateral route rights in a limited-entry market. Delta will enhance intergateway competition given its demonstrated ability to feed on-line passengers into its Atlanta hub and would provide broad geographic coverage to this market by affording passengers access to its interconnecting network. Delta offers single-plane service behind the Buffalo gateway to its Atlanta hub where passengers have on-line connections to 98 nonstop destinations with 434 daily departures.[9]

Finally, we find that the transfer will have a positive impact on the U.S. trade position in the Canadian market by facilitating continued competitive U.S.-flag services between Buffalo and Toronto and thereby strengthening the U.S. carrier presence in the market.

Motion for Confidential Treatment

The joint applicants filed separate motions requesting confidential treatment of certain documents pursuant to exemption 4 of the Freedom of Information Act, 5 U.S.C. 552(b)(4), as being "commercial or financial information obtained from a person and privileged or confidential." The applicants claim that these documents contain information regarding internal strategies, objectives and methodology with respect to competitively sensitive matters including routes, finances, expansion plans and marketing. After reviewing the material submitted by the applicants under the guidelines of Rule 39, it is our view that these documents should be granted confidential treatment, pursuant to the

exemption under the Freedom of Information Act for proprietary information, 5 U.S.C.552(b)(4).

ACCORDINGLY,

1. We approve the joint application of Eastern Air Lines, Inc. and Delta Air Lines, Inc. for transfer to Delta Air Lines, Inc., under section 401(h) of the Federal Aviation Act, of that portion of Continental/Eastern's certificate authority on Route 148, authorizing scheduled combination service between

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[8] The U.S.-Canada agreement does not provide for service in the Buffalo-Toronto market by a Canadian carrier. Thus no Canadian carrier serves the market. See Joint Application at 10.

[9] Joint application at 9.

the terminal point Buffalo, New York, and the terminal point Toronto, Canada;

2. We amend the certificate for Route 148 jointly held by Eastern Air Lines, Inc. and Continental Airlines, Inc. in the form attached, to substitute the phrase "New York-N.Y.-Newark, N.J." for "Buffalo, New York" in the listed route segment and to delete the phrase "Buffalo, N.Y." from condition eight (8);

3. We issue to Delta Air Lines, Inc., in the form attached, a certificate of public convenience and necessity authorizing service between Buffalo, New York and Toronto, Canada.

4. We grant the motions of Eastern Air Lines, Inc., and Delta Air Lines, Inc. for confidential treatment;

5. Since no party opposes the transfer, we will not entertain petitions for reconsideration of this order;

6. To the extent not granted, deferred, or dismissed, we deny all motions and requests in the docket;

7. Unless disapproved by the President of the United States under section 801(a) of the Act, this order and the attached certificate shall become effective on the 61st day following its submission for section 801 review, or upon the date of receipt of advice from the President or his designee under Executive Order 12597 and implementing regulations that he or she does not intend to disapprove the Department's order under that section, whichever occurs earlier;[10] and

[10] This order was submitted for section 801 review on September 24, 1991. On October 17, 1991, we received notification that the President's designee under Executive Order 125 and implementing regulations did not intent to disapprove the Department's order

8. We will serve copies of this order upon Eastern Air Lines, Inc., Delta Air Lines, Inc., Continental Airlines, Inc., the ambassador of Canada in Washington, D.C., the U.S. Department of State (Office of Aviation), the Federal Aviation Administration, and the Department of Justice (Antitrust Division).

By:

JEFFREY N. SHANE
Assistant Secretary for Policy
and International Affairs

(SEAL)

Public Law 85-726 Title IV
AIR CARRIER ECONOMIC REGULATION

TITLE IV- AIR CARRIER ECONOMIC REGULATION

Certificate of Public Convenience and Necessity

Certificate Required

Sec. 401.

(a) No air carrier shall engage in any air transportation unless there is in force a certificate issued by the Board authorizing such air carrier to engage in such transportation.

Application for Certificate

(b) Application for a certificate shall be made in writing to the Board and shall be so verified; shall be in such form and contain such information, and shall be accomplished by such proof of service upon such interested persons, as the Board shall by regulation require.

Notice of Application

(c) Upon filing for such application, the Board shall give due notice thereof to the public by posting a notice of such application in the office of the secretary of the Board and to such other persons as the Board may by regulation determine. Any interested person may file with the Board a protest or memorandum of opposition to or in support of the issuance of a certificate. Such application shall be set for public hearing, and the Board shall dispose of such application as speedily as possible.

Issuance of Certificate

(d)

(1) The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

(2) In the case of an application of a certificate to engage in temporary air transportation, the Board may issue a certificate authorizing the whole or any part thereof for such limited periods as may be required by the public convenience and necessity, if it finds that the applicant is fit, willing, and able properly to perform such transportation and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder,

Terms and Conditions of Certificate

(e) Each certificate issued under this section shall specify the terminal points and intermediate points, if any, between which the air carrier is authorized to engage in air transportation and the service to be rendered; and there shall be attached to the exerciser of the privileges granted by the certificate, or amendment thereto, such reasonable terms, conditions, and limitations as the public interest may require. A certificate issued under this section to engage in foreign air transportation shall, insofar as the operation is to take place without the United States, designate the terminal and intermediate points only insofar as the Board shall deem practicable and otherwise shall designate only the general route to be followed. Any air carrier holding a certificate for foreign air transportation shall be authorized to handle and

transport mail of countries other than the United States. No term, condition, or limitation of a certificate shall restrict the right of an air carrier to add to or change schedules, equipment, accommodations, and facilities for performing the authorized demands of the public shall require. No air carrier shall be deemed to have violated any term, condition, or limitation of its certificate by landing or taking off during an emergency at a point not named in its certificate or by operating in an emergency under regulations which may be prescribed by the Board, between terminal and intermediate points other than those specified in its certificate. Any air carrier may make charter trips or perform any other special services, without regard to the points named in its certificate, under regulations prescribe by the Board.

Effective Date and Duration of Certificate

(f) Each certificate shall be effective form the date specified therein, and shall continue in effect until suspended or revoked as hereinafter provided, or until the Board shall certify that operation there under has ceased, or, if issued for a limited period of time under subsection (d) (2) of this section, shall continue in effect until the expiration thereof, unless, prior to the date of expiration, such certificate shall be suspended or revoked as provided herein, or the Board shall certify that operations there under have ceased: *Provided.* That if any service authorized by a certificate is not inaugurated within such period, not less than ninety days, after the date of the authorization as shall be fixed by the Board, or if, for a period of ninety days or such other period as may be designated by the Board any such service is not operated, the Board may by order, entered after notice and hearing, direct that such certificate shall thereupon cease to be effective to the extent of such service.

Authority to Modify, Suspend, or Revoke

(g) The Board upon petition or complaint or upon its own initiative, after notice and hearings, may alter, amend, modify, or suspend any such certificate, in whole or in part, if the public convenience and necessity so require, or may revoke any such certificate, in whole or in part, for international failure to comply with any provision of this title or any order, rule, or regulation issued hereunder or any term, condition, or limitation of such certificate: *Provided* that no such certificate shall be revoked unless the holder thereof fails to comply, within a reasonable time to be fixed by the Board, with an order of the Board commanding obedience to the provision, or to the order(other than an order issued in accordance with this proviso), rule, regulation, term, condition, or limitation found by the Board to have been violated. Any interested person may file with the Board a protest or memorandum in support of or in opposition to the alteration, amendment, modification, suspension, or revocation of the certificate.

Transfer of Certificate

(h) No certificate may be transferred unless such transfer is approved by the Board as being consistent with the public interest.

Certain Rights not Conferred by Certificate

(i) No certificate shall confer any propriety, property, or exclusive right in the use of any airspace, Federal airway, landing area, or air-navigation facility.

Application for Abandonment

(j) No air carrier shall abandon any route, or part thereof, for which a certificate has been issued by the Board, unless, upon the application of such air carrier, after notice

and hearing, the Board shall find such abandonment to be in the public interest. Any interested person may file with the Board a protest or memorandum of opposition to or in support of any such abandonment. The Board may, by regulations or otherwise, authorize such temporary suspension of service as may be in the public interest.

Compliance with Labor Legislation

(k)

(1) Every air carrier shall maintain rates of compensation, maximum hours, and other working conditions and relations of all of its pilots and copilots who are engaged in interstate air transportation within the continental United States (not including Alaska) so as to conform with the decision numbered 83 made by the National Labor Board on May 10, 1934, not withstanding any limitation therein as in the period of its effectiveness.

(2) Every air carrier shall maintain rates of compensation for all of its pilots and copilots who are engaged in overseas or foreign air transportation or air transportation wholly within the Territory of possession of the United States, the minimum of which shall be not less, upon an annual basis, than the compensation required to be paid under said decision 83 for comparable service to pilots and copilots engaged in interstate air transportation within the continental United States (not including Alaska).

(3) Nothing herein contained shall be construed as restricting the right of any such pilots and copilots, or other employees, of any such air carrier to obtain by collective bargaining higher rates of compensation or more favorable working conditions or relations.

(4) It shall be a condition upon holding of a certificate by any air carrier that such carrier shall

comply with title II of the Railway Labor Act, as amended.

(5) The term "pilot" as used in this subsection shall mean an employee who is responsible for the manipulation of or who manipulates the flight controls of an aircraft while under way including takeoff and landing of such aircraft, and the term "copilot" as used in this subsection shall mean an employee any part of whose duty is to assist or relieve the pilot in the manipulation, and who is properly qualified to serve as, and holds a currently effective airman certificate authorizing him to serve as, such pilot and copilot. ***(Emphasis added)***

Requirement as to the Carriage of Mail

(l) Whenever so authorized by its certificate, any air carrier shall provide necessary and adequate facilities and service for the transportation of mail, and shall transport mail whenever required by the Postmaster General. Such air carrier shall be entitled to receive reasonable compensation therefore as hereinafter provided.

Application for New Mail Service

(m) Whenever, from time to time, the Postmaster General shall find that the needs of the Postal Service require the transportation of the mail by aircraft between any points within the United States or between the United States and foreign countries, in addition to the transportation of mail authorized in certificates then currently effective, the Postmaster General shall certify such finding to the Board and file therewith a statement showing such additional service and the facilities necessary in connection therewith, and a copy of such certification and statement shall be posted for at least twenty days in the office of the secretary of the Board. The Board shall, after notice and hearing, and if found by it to required by the public convenience and

necessity, make provision for such additional service, and the facilities necessary in connection therewith, by issuing a new certificate or certificates or by amending an existing certificate or certificates in accordance with the provisions of this section.

John G. Loomis, Esq
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(305) 233-4005
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NATIONAL MEDIATION BOARD
2002 JAN 29 P 12:14

January 29, 2002

Via Telefax to (202) 692-5086

Ms. Carol Conrad
Senior Assistant
Arbitration
National Mediation Board
Washington D. C. 20572

Re: Eastern Airlines Inc., Continental Airlines Inc., and Continental Airlines Section 13 LPP arbitration

Dear Ms. Conrad,

This letter is a follow-up of Ramon E. O'Neill's telephone request that the National Mediation Board furnish the undersigned with a panel of seven neutrals from which the parties to the above dispute may select the arbitrator who will chair the aforementioned LPP arbitration.

It would be most helpful if the individuals whose names are proferred have served as arbitrators on arbitration boards created by a collectively bargained agreement and/or as a neutral assigned to the System Board of Adjustment

established under the provisions of the Railway Labor Act,as amended.

Four such names that come to mind: Richard I. Block, Frank Elkouri, Richard Kasher, and Jerome Ross. Needless to say, seasoned arbitrators who have experience integrating the Pilot System Seniority Lists of merged airlines will be better poised to expedite the hearing portion of this LPP arbitration and to prepare his or her opinion and award in a timely fashion.

Yours very truly,

s/ John G. Loomos

BANKRUPTCY CODE RULE 6006

Rule 6006. - Assumption, Rejection or Assignment of an Executory Contract or Unexpired Lease

(a) Proceeding To Assume, Reject, or Assign

A proceeding to assume, reject, or assign an executory contract or unexpired lease, other than as part of a plan, is governed by **Rule** 9014.

(b) Proceeding To Require Trustee To Act

A proceeding by a party to an executory contract or unexpired lease in a chapter 9 municipality case, chapter 11 reorganization case, chapter 12 family farmer's debt adjustment case, or chapter 13 individual's debt adjustment case, to require the trustee, debtor in possession, or debtor to determine whether to assume or reject the contract or lease is governed by **Rule** 9014.

(c) Notice

Notice of a motion made pursuant to subdivision (a) or (b) of this **rule** shall be given to the other party to the contract or lease, to other parties in interest as the court may direct, and, except in a chapter 9 municipality case, to the United States trustee.

(d) Stay of Order Authorizing Assignment

An order authorizing the trustee to assign an executory contract or unexpired lease under Sec. 365(f) is stayed until the expiration of 10 days after the entry of the order, unless the court orders otherwise

BANKRUPTCY CODE RULE 9014

Rule 9014. - Contested Matters

(a) Motion
In a contested matter not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. No response is required under this rule unless the court directs otherwise.

(b) Service
The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004. Any paper served after the motion shall be served in the manner provided by Rule 5(b) F. R. Civ. P.

(c) Application of Part VII Rules
Unless the court directs otherwise, the following rules shall apply: 7009, 7017, 7021, 7025, 7026, 7028-7037, 7041, 7042, 7052, 7054-7056, 7064, 7069, and 7071. An entity that desires to perpetuate testimony may proceed in the same manner as provided in Rule 7027 for the taking of a deposition before an adversary proceeding. The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply. The court shall give the parties notice of any order issued under this paragraph to afford them a reasonable opportunity to comply with the procedures prescribed by the order.

(d) Testimony of Witnesses

Testimony of witnesses with respect to disputed material factual issues shall be taken in the same manner as testimony in an adversary proceeding.

(e) Attendance of Witnesses

The court shall provide procedures that enable parties to ascertain at a reasonable time before any scheduled hearing whether the hearing will be an evidentiary hearing at which witnesses may testify

,IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

In re:	) Chapter 11
	)
CONTINENTAL AIRLINES INC	)Case NOS. 90-932
Et al.	)Thru 90-984 (MFW)
Debtors	)

OPINION 1

Before the Court is the Amended Motion of Continental Airlines, Inc.("Continental") seeking an Order compelling the Eastern Arbitration Group, Inc., and its individual members ("the EAG"), and the Eastern Pilots Merger Committee and its individual members ("the EPMC")(collectively, "the Respondents") to comply with Orders of this Court and the Appellate Courts, finding the Respondents in civil contempt of court and imposing sanctions on the Respondents. After considering the arguments of both parties, prior findings of this Court and prior rulings of the Third Circuit in this case, we conclude that Continental's Motion must be denied for the following reasons.

1 This opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052, which is made applicable to contested matters by Federal Rule of Bankruptcy Procedure 9014.

I. FACTUAL BACKGROUND

On February 23,1986, Eastern Airlines ("Eastern") and its pilots' union, the Air Lines Pilot Association ("ALPA)

ratified a collective bargaining agreement ("the CBA).On February 24, 1986, Texas Air Corporation, the parent of Continental acquired Eastern. ALPA asserted that the acquisition was a merger requiring the integration of the Eastern and Continental pilot seniority lists pursuant to the CBA. When Eastern and Continental refused to bargain, ALPA initiated arbitration.

In March, 1989, Eastern filed bankruptcy and asserted that the automatic stay precluded ALPA from proceeding with the arbitration. The Second Circuit Court of Appeals disagreed and held that the automatic stay did not stay the continuation of the arbitration. In re Ionosphere Clubs, Inc., 922 F.2d 984 (2d Cir. 1990) .Thereafter, ALPA continued the arbitration seeking the integration of the Eastern and Continental pilot seniority lists and back pay.

In December 1990, Continental filed bankruptcy in this Court. ALPA and certain individual Eastern pilots filed protective proofs of claims asserting that, as a result of Continental's acquisition of Eastern, the Eastern pilots were entitled to specific performance of seniority rights granted them under the CBA. Continental objected to these claims and sought a declaration that the claims were general unsecured pre-petition

claims compensable by an award of monetary damages, which were thus dischargeable in bankruptcy. ALPA disagreed and asserted that the pilots were entitled to seniority integration pursuant to the CBA and that only the arbitrator had jurisdiction to determine the appropriate remedy. In February 1993, the Bankruptcy Court sustained Continental's objection to the ALPA claims and classified them as general unsecured obligations.

In April 1993, the Bankruptcy Court entered an order confirming Continental's Plan of Reorganization ("the Confirmation Order"). The Confirmation Order concluded that any claim under the CBA gave rise to a right of payment dischargeable in bankruptcy and that no right to equitable relief was available. Consequently, the Confirmation Order enjoined the arbitration proceeding.

ALPA and the individual Eastern pilots appealed. While the appeal was pending, ALPA entered into a settlement agreement with Continental that was accepted by approximately two-thirds of the Eastern pilots. The pilots who chose not to accept the settlement ("the Remaining Claimants") continued the appeal. Subsequently, the District Court affirmed the Confirmation Order except with respect to the injunction of the arbitration proceeding. In re Continental Airlines, Inc., No. 93-163 (D. Del. Nov. 29, 1995). Both parties appealed to the Third Circuit.

On August 29, 1997, the Third Circuit issued its decision

affirming the District Court. The Court held that the Eastern pilots' claims for seniority integration could be converted into money damages In re Continental Airlines, 125 F.3d 120 (3d Cir. 1997) (Continental I). Consequently, the Court concluded that those claims could be treated and discharged in Continental's Plan of Reorganization. Id. at 135-36.The Court also held, however, that the Bankruptcy Court could not enjoin the arbitration proceeding because Continental had not rejected the CBA in accordance with section 1113. Id. 136-38. A Petition for Writ of Certiorari was denied by the Supreme Court. LLPClaimants v. Continental Airlines, 522 U.S. 1114 (1998).

On October 12, 1999, some of the Remaining Claimants commenced a class action adversary proceeding in

Continental's bankruptcy case ("the Baldridge Class Action"). The Baldridge Class Action sought a determination that the one-year cap in section 502 (b) (7) of the Bankruptcy Code did not apply to their claims under the CBA. By Order dated February 3, 2000, the Baldridge Class Action was certified as a class. Baldridge v. Continental AirlinesL Inc. (In re Continental Airlines, Inc.), Adv. No. 99-412 (Bankr. D. Del. February 3,2000).The Remaining Claimants were permitted to elect whether to pursue their claims in the Baldridge Class Action or in an action previously commenced by the EPMC .Baldridge Stipulation and Order on Motion to Intervene' 3, February 3, 2000).Those who opted out

of the Baldridge Class Action, however, were required to waive their claims against Continental. Id.

In the interim, on October 23, 1998, the EPMC had commenced a lawsuit in the District Court in New Jersey against Continental seeking post-petition enforcement of the CBA ("the New Jersey Action") . Continental filed a motion in this Court seeking an Order enjoining that suit as a violation of the Confirmation Order. We concluded that the Confirmation Order had discharged all claims of the Eastern pilots. In re Continental Airlines, Inc., 236 B.R. 318, 332 (Bankr. D. Del. 1999). We, therefore, held that the Confirmation Order enjoined the New Jersey Action. Id. On appeal, the District Court agreed and held that Continental I precluded any post-confirmation relief even though the CBA survived the bankruptcy process In re Continental Airlines. Inc., 2000 WL 1425751, at *3 (D. Del. Sept. 12, 2000).

On appeal to the Third Circuit, the EPMC asserted that the Eastern pilots had a post-petition right to enforce the CBA because Continental failed to reject the CBA in accordance with the requirements of section 1113 of the

Bankruptcy Code In re Continental Airlines. Inc., 279 F.3d 226, 229 (3d Cir. 2002) (Continental II). The Third Circuit disagreed, stating that Continental I held that any claim based on the award of seniority, whether pre or post-petition, was compensable by money damages. Id. Accordingly, the Third Circuit held that the

5

Eastern pilots' claims were barred by its previous decision and the Confirmation Order. Id. at 232.

Concurrently, in the Baldridge Class Action, we concluded that the Eastern pilots' claims were subject to the one-year cap contained in section 502 (b) (7). Ultimately, however, a settlement was reached allowing class members' claims in an amount in excess of the cap.

On or about April 7, 2003, representatives of the Respondents filed a petition with the National Mediation Board ("NMB") seeking to resume arbitration under the CBA. The Respondents consist of two groups of Eastern pilots, the RAG and the EPMC, who did not settle their claims (either through the ALPA settlement or the Baldridge Class Action settlement). On May 16, 2003, counsel to Continental sent correspondence to the NMB asserting that any attempt to accede to the Respondent's request was in direct contravention of the Orders of this Court, the District Court and the Third Circuit. Despite this assertion, the Respondents renewed their request for arbitration, asserting that they had not waived any rights, had not settled any claims and had not had their right to arbitration affected.

II. JURISDICTION

This Court has jurisdiction over this Motion pursuant to 28 U.S.C. § 1334 and § 157 (b) (1), (b) (2)(A), (B), & (0).

III. DISCUSSION

The Motion requires us to interpret the decisions of the Third Circuit in this very case. 2 In rendering our decision, we are bound by the doctrine of law of the case to "implement both the letter and the spirit of the mandate, taking into account the appellate court's opinion and the circumstances it embraces". Continental, 236 B.R. at 322 (citing Casey v. planned Parenthood o£Southeastern Pennsylvania, 14 F.3d 848, 857 (3d Cir. 1994).

A. Effect of the Discharge Injunction

Continental asserts that the Respondents violated the Confirmation Order when they sought a resumption of the arbitration proceeding. Although the Third Circuit's decision in COntinental I vacated the Confirmation Order to the extent it prevented arbitration under the CBA, Continental asserts that the Court's ruling left intact all other aspects of the Confirmation Order and that, because of changed circumstances, the Respondents' actions are a violation of the discharge injunction.

We disagree. We conclude that the Respondents' request for arbitration does not violate the Confirmation Order or any other order entered in this case. In Continental I, the Third Circuit upheld the District Court's dissolution of the injunction of

2 In fact, this is the second time that we have been asked to interpret the decision of the Third Circuit on this very issue. Continental, 236 B.R. 318.

arbitration. Continental I, 125 F.3d at 136-37. The Court concluded that section 1113 of the Bankruptcy Code renders

the injunction invalid because Continental failed to reject the CBA. Id. The intent of section 1113 is to preclude debtors from unilaterally terminating a collective bargaining agreement without following its strict mandate. Id. at 137. The Court consequently held that the discharge injunction could not apply to the arbitration because enforcing it would have the effect of permitting Continental to escape its duty to arbitrate under the CBA. Id. The Court specifically rejected Continental's argument that it had no duty to arbitrate and concluded, on the contrary, that Continental was bound to arbitrate. Id. Accordingly, we must follow the law of the case and conclude that the discharge injunction does not enjoin the Respondents' attempt to resume the arbitration under the CBA.

B. Futility of Arbitration

Continental contends that the Respondents' action is improper because they are bound by the settlement in the Baldridge Class Action or are entitled to no relief because they waived their claims. Accordingly, Continental asserts that it should not be forced to arbitrate the Respondents' claims because their attempt to recover from Continental is futile.

The Respondents contend, however, that even if they cannot recover from Continental, the resumption of arbitration is

appropriate because it may serve other purposes.

In particular, they assert that they continue to have a contractual and statutory right to pursue arbitration that may generate a recovery from parties other than continental.

Again, we find that we are bound by the decision of the

Third Circuit in Continental I. In concluding that the right to seniority integration gave rise to monetary damages, the Third Circuit determined that the claims were dischargeable in bankruptcy. Continental I, 125 F.3d at 136. The Third Circuit, however, limited its holding to how the claims would be treated in Continental's bankruptcy. Id. The Court did not determine if an award was warranted, whether an award should be granted or who would be liable should an arbitration award be granted. Id. At the time it upheld the right to arbitrate under the CBA, the Third Circuit knew that any award the arbitrator may enter against Continental was discharged by the Confirmation Order. It nonetheless concluded that the arbitration should be permitted to proceed. The facts are no different now. Thus, we cannot enjoin the arbitration.

In fact, although the Respondents are barred from recovering any award the arbitrator may enter against Continental, simply obtaining that award may be sufficient. As the Third Circuit noted, the process of arbitration itself has a salutary purpose. Hays and Co. V. Merrill Lynch, 885 F.2d 1149, 1158 (3d Cir.

1989). Even a pyrrhic victory may be significant from the personal perspective of the Respondents, who have expended considerable time (almost 13 years), energy and money to prove that Continental and Eastern Airlines wronged them. Further, we cannot discount the precedential effect which any decision may have in future dealings, if any, between the parties and their representatives.

In support of its position that the Respondents lack a basis to pursue arbitration, Continental also relies on the Third Circuit's decision in Continental II. However, in Continental II the Third Circuit was not asked to enjoin the arbitration; rather it was asked to enjoin a law suit. Further, the Third

Circuit concluded that the New Jersey Action was improper because the EPMC was attempting to relitigate an issue previously decided by the Court. Continental II, 279 F.3d at 233. The Court explained that the right to seniority integration, for both pre and post petition conduct, gave rise to a claim dischargeable in bankruptcy. Id. at 231. The Court did not, however, modify its ruling in Continental I that its arbitration could was not be enjoined. Id. at 228. As a result, we conclude that Continental II does not compel us to enjoin the arbitration now sought by the Respondents.

Continental asserts that the arbitration proceeding cannot provide a remedy that will not be contrary to the Confirmation

Order. We disagree. Continental ignores the possibility that the arbitration could impact other parties. The Respondents assert that they may be entitled to a remedy against the Continental pilots or others; they assert that to obtain such an award Continental must be a named party in the arbitration. While the Respondents may not be entitled to a recovery from Continental's estate, this does not preclude any relief in the arbitration. Further, the Baldridge Class Action settlement provided that members who withdrew their claims were entitled to pursue damages and such other relief as may be awarded in any judicial forum or arbitration proceeding. (Baldridge Stipulation and Order on Motion to Intervene _ 5). This reservation of rights, in conjunction with the Third Circuit's holding in Continental I, clearly provides the Respondents with a right to demand arbitration under the CBA and to pursue anyone other than Continental against whom they may have rights.

The Respondents concede that any award that the arbitrator may enter against Continental would be subject to the discharge provided in the Confirmation Order. They have

agreed to this Court's jurisdiction to determine whether enforcement of that remedy would violate any Orders entered in this case. That is sufficient protection to Continental to assure that the Orders of this Court will not be violated. Thus, we conclude that no Order previously entered in this case bars the resumption of

arbitration by the Respondents and, in fact, the Third Circuit decision in Continental I expressly preserved the right of the Respondents to proceed with arbitration. Accordingly, Continental's Motion must be denied.

IV. CONCLUSION

For the reasons set forth above, we deny Continental's Motion seeking an Order to Compel Respondents to Comply with Orders.

An appropriate Order is attached.

BY THE COURT:

Dated: December 17, 2003

s/ Mary F Walrath
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:	)	
	)	Case No. 02-83984-SSM
US AIRWAYS GROUP, Inc..)		Chapter 11
	)	(Jointly Administered)
Debtors	)	

MEMORANDUM OPINION

A hearing was held in open court on February 21, February 24, February 28, and March 1, 2003, on the debtors' motion for a determination that they satisfy the financial requirements for a "distress" termination of the retirement income plan for pilots of US Airways, Inc. The motion also seeks approval of the termination, a finding that termination would not violate the terms of the collective bargaining agreement between the debtors and the pilots' union, and approval of a follow-on defined contribution retirement plan for the pilots.

The motion is supported by the Official Committee of Unsecured Creditors but opposed by the Air Line Pilots Association ("ALPA") - the union bargaining representative for the debtors' pilots - as well as by the Retired Pilots Association of US Airways ("the Soaring Eagles"), the Piedmont Silver Eagles, eighteen pilots known as the Lump Sum Eligible Pilots, another group of pilots led by Elwood Menear and Edward Graf, and by approximately 49 *pro se* active and retired pilots, at least one widow of a pilot, and at least one former spouse of a pilot. The Pension Benefit Guaranty Corporation (" PBGC") - which would be responsible for paying insured benefits under the terminated plan - filed a response taking no position on

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whether the plan should be terminated but urging the court to require appropriate proof and to make adequate findings.

At the conclusion of the hearing, the court made findings orally on the record and ruled that the debtors satisfied the requirements for a distress termination and would be allowed to terminate the plan, subject to a determination that doing so would not violate the collective bargaining agreement between the debtors and ALPA. That issue, the court ruled, would have to be resolved under the arbitration mechanism established by the collective bargaining agreement itself. An order reflecting the court's ruling was entered on March 2, 2003. The purpose of this opinion is to supplement the oral findings of fact and to explain in somewhat more detail, particularly for parties who were not present at the hearing, the reasons for the court's ruling.

Findings of Fact and Procedural Background

US Airways is the seventh largest air passenger carrier in the United States, and the largest east of the Mississippi River. Its parent holding company, US Airways Group, Inc., and seven subsidiaries - among them US Airways, Inc., Allegheny Airlines, Inc., Piedmont Airlines, Inc., and PSA Airlines, Inc. 1 - filed voluntary petitions in this court on August 11, 2002, for reorganization under chapter 11 of the Bankruptcy Code. Since that date, they have continued to operate their business as debtors in possession. A joint plan of reorganization has

1 Allegheny, Piedmont, and PSA operate short-haul turboprop aircraft under the name US Airways Express.

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been proposed and has been submitted to creditors for a vote.

A hearing on plan confirmation is scheduled for March 18, 2003.

The pilots of US Airways are represented by ALPA. US Airways and ALP A are parties to a collective bargaining agreement that became effective on January 1, 1998. The collective bargaining agreement requires US Airways to maintain for its pilots a defined benefit retirement plan with certain specified benefits. The plan has two components - a tax qualified plan and a non-qualified or so-called "Top Hat" plan. By law, pilots are required to retire at age 60. The amount of the pension is calculated based on age, years of service, and final average earnings. Pilots who retire at age 60 may elect a lump-sum payment. There is also an option for joint and survivor benefits.

As a result of financial distress that predated, but was exacerbated by, the terrorist attacks of September 11, 2001 (" 9/11"), US Airways brought in new management in March 2002 and began efforts to restructure its operations. As part of that effort, it negotiated with its unions, including ALPA, for wage and other concessions that would make the airline more competitive. An agreement was reached with ALP A ("the first-round concessions") approximately a month prior to the chapter 11 filing. None of these concessions modified the terms of the pilots' pension plan, although the salary reductions did have the incidental effect of somewhat reducing the future obligations under the plan. As part of the agreement, the debtor agreed, if it were to file for chapter 11, not to seek relief from the collective bargaining agreement under §§ 1113 or 1114, Bankruptcy Code.

Prior to the chapter 11 filing, US Airways submitted an application to the Air Transportation Stabilization Board ("ATSB") for a $900 million guarantee with respect to a

proposed $1 billion loan. This approval was based on a 7-

year business plan which required the debtor to achieve certain targeted reductions in operating costs. Tentative approval of the guarantee was given prior to the chapter 11 filing. Although US Airways had initially hoped to effect its restructuring outside of chapter 11, it ultimately determined that it could not reach all necessary agreements without filing for chapter 11, which, as noted, occurred on August 11, 2002.

Since the outset of the case, the debtors have aggressively pursued a "fast track" reorganization, with the announced goal of being out of chapter 11 by the end of first-quarter 2003. They achieved substantial "first-round" concessions from those unions with which they had not reached agreement prior to the chapter 11 filing, have saved large sums by abandoning unneeded aircraft, and have negotiated substantial reductions in payments on aircraft they have kept. To maintain cash liquidity during the reorganization process, the debtors, with court approval, entered into a $500 million post-petition credit facility ("the DIP loan") with the Retirement Systems of Alabama ("RSA"). Of this amount $300 million has already been drawn down. RSA is also the "plan sponsor" under an agreement whereby it will invest $240 million at confirmation in exchange for a 37% interest in the reorganized debtors. Finally, RSA has agreed to loan $75 million of the non-guaranteed (or "at risk") portion of the $1 billion A TSB loan. Despite the debtors' efforts, the path to profitability and emergence from chapter 11 has not been smooth. In particular, in the October to November 2002 time frame, two serious problems surfaced that threatened the debtor's business plan, which in turn was the foundation for the A TSB loan guarantee and a predicate for the RSA investment. The first was a dramatic

shortfall in revenue, as airline passenger revenues throughout the industry remained substantially below pre-9/ 11 levels. As a result, the revised revenue projections for 2003 – the year of the planned emergence from chapter 11 - were $997 million below the original projections. Coupled with an additional increase of $51 million in fuel costs, this left the debtors with a projected pre-tax loss for 2003 of over $800 million instead of the modest $122 million profit that was projected in the business plan.

The second problem that emerged was a serious funding shortfall for the debtors' defined benefit pension plan over the 7 -year period of the business plan. The debtor maintained four defined benefit plans, among them the ALP A plan. Two factors conspired to create the funding shortfall. First, protracted poor performance by the stock market had resulted in a significant decline in the value of the plan assets. Second, the decline in long term interest rates to a 40-year historic low had increased the amount of the current liabilities for the plans, since current liabilities are determined based on the cost of an annuity to pay the specified benefit, and that cost, in turn, rises as long-term interest rates fall.

The debtors responded to the revenue shortfall by seeking additional savings from its labor force, its aircraft lenders and lessors, and its vendors. The negotiations with its unions, including ALPA, for a "second-round" of concessions took place in early December 2002, as the debtors struggled to meet their goal of filing a plan of reorganization by December 20, 2002. The concessions by ALP A - which was the only labor group to agree to the full amount requested by the company - totaled $179 million, of which $101 million represented primarily work-rule changes and wage reductions, and $78 million represented modifications

to the accrual formula for the pension plan. The concessions were embodied in two documents referred to as Letter of Agreement ("LOA") 83 and LOA 84.

At the time these negotiations were taking place, the debtors were also attempting to find a solution for the funding shortfall in its defined benefit retirement plans. As projected by the plans' actuaries, the required contributions over the seven years of the ATSB loan and the business plan were as follows:

Year	All 4 Plans	Pilots Plan
2003	$51 million	$51 million
2004	$753 million	$525 million
2005	$538 million	$337 million
2006	$425 million	$275 million
2007	$346 million	$222 million
2008	$246 million	$74 million
Total	$2.453 Billion	$1.659 billion

One solution investigated by the debtors involved "restoration funding," under which, as the debtors viewed the law, the PBGC could approve a 30-year amortization of the funding shortfall. For the pilots' plan, restoration funding would require the debtor to pay approximately $122 million per year, or $854 million over the seven years of the business plan, instead of the $1. 659 billion that would be required without such relief. The other solution contemplated waivers by the Internal Revenue Service ("IRS") of the funding

contributions that would have been required in 2004 and subsequent years. Looming over all

of this was the realization that the PBGC could involuntarily terminate the plans because of their under - funded state.

As a condition of agreeing to the second round of concessions, the ALP A negotiating committee demanded a letter from US Airways to ensure that, if the pension plan were terminated, US Airways would not simply pocket the money it was otherwise obligated to pay into the plan. This letter ("the side letter"), which is undated - and for that matter, unsigned was delivered to the negotiating committee on December 13, 2003. It stated in relevant part:

"If the PBGC and the IRS reject the Company's request for long-tern funding relief and this results in termination of the plan, the freezing of the plan or significant modification in Plan benefits from those negotiated in the 2002 Supplementary Cost Reduction Agreement (" Agency Action"), the parties agree to meet and confer for the purpose of negotiating alternate pilot retirement benefits.

If the Plan is terminated, the alternate pilot retirement plan shall provide benefits from and after the effective date of the termination that resemble, in the aggregate, the benefits pilots would have earned... absent the termination. "

The letter limited the company's commitment with respect to the follow-up plan by stating that such a plan "may" take the form of a defined contribution plan and that the company's "cash cost... may in no event exceed [the] restoration funding cost in any year." The cost that the debtors had projected in their business plan for restoration funding of the pilots pension plan was $122 million per year. The chairman of the

ALP A negotiating committee testified that the reference in the side letter to plan "termination" was intended to address the possibility of an involuntary termination by the PBGC and was not intended by ALP A as consent for the debtors to initiate a distress termination. Indeed, ALP A has filed a grievance under the

collective bargaining agreement asserting that the debtors' notice of intent to terminate the plan violates the terms of the agreement.

By its terms, the side letter was to be kept confidential until" Agency Action" had occurred. The debtors and representatives from ALP A had met with the PBGC on November 22, 2002, to discuss the restoration funding approach. Around December 11, 2002, the debtors received a copy of a legal memorandum from PBGC's general counsel opining that restoration funding could not be approved. The debtors then submitted a legal memorandum to the PBGC taking issue with that analysis. The debtors and representatives of ALP A met with the IRS on December 13, 2002, but received no encouragement that a waiver solution would be available. Finally, the debtors and ALP A approached friendly senators from states in which US Airways had a presence and managed to have a bill introduced in Congress that would have provided US Airways with funding relief equivalent to what it would have achieved from restoration funding. That legislation was defeated in committee on January 9, 2003. A hearing was held on January 14, 2003, at which representatives of ALP A and the debtor testified in favor of a legislative solution. However, an attempt on the Senate floor to incorporate the

relief as an amendment to a continuing resolution was defeated on January 22, 2003. Eight days later - January 30, 2003 - the debtors gave the PBGC and the ALPA plan participants 60 days notice that the debtors intended to terminate the pilots defined benefit plan on March 31, 2003.

Simultaneously with the giving of the notice, the debtors filed the present motion and noticed it for hearing on February 20, 2003. Because of other matters being heard that day, the hearing - which extended over a period of four full days - did not commence until

February 21, 2003. At the hearing, the debtors presented evidence that their business plan which is the basis of the ATSB loan guarantee approval and a predicate for the RSA investment - is based on "an assumed 30-year amortization of unfunded pension liability." For the pilots' plan, such restoration funding would cost the company approximately $805 million less over the seven years of the business plan than the projected funding requirement in the absence of restoration funding. Relevant features of the business plan may be summarized as follows:

Year	2003	2004	2005	2006	2007	2008	2009
Revenue	$7,133	$8,112	$8,702	$9,193	$9,414	$9,501	$9,586
Pre-tax Income	$ (229)	$ 122	$ 363	$ 571	$ 625	$ 593	$ 587
Ending cash	$1,04	$1,288	$1,647	$1,894	$2,042	$1,994	$1,920

The debtor's chief financial officer testified that within the airline industry, cash reserves equal to approximately 20% of revenues would be necessary for the debtor to be viewed as financially healthy, and that absent appropriate levels of cash, the company could not obtain the financing necessary

to implement its long-term business strategy of shifting to the use of regional jets on routes that are currently unprofitable. He further testified that in the absence either of restoration funding or the ability to terminate the pilots' pension plan the additional amounts due in 2004 and 2005 to maintain the current plan would reduce the debtor's projected cash below acceptable levels. As noted, the required contributions for those two years, as calculated by the plan's actuaries, would total $862 million, or approximately $618 million more than the amount that would be required under the $122 million a year for restoration funding. The debtors' financial advisor testified that without a "resolution" of the

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2 Figures are in millions of dollars.

pension funding issue that will enable the reorganized debtors to meet the projections in their business plan, the ATSB is unlikely to issue its guarantee and RSA is unlikely to make its investment. Indeed, the A TSB, in a letter dated February 11, 2003, while approving the $900 million guarantee (based on a finding that the debtor's revised business plan was financially sound and presented a reasonable assurance of repayment of the proposed loan) made its approval subject to a number of conditions, among them that "[a] resolution of the Applicant's pending funding issue must be approved by the PBCG and, if necessary, the Bankruptcy Court." The letter goes on to state:

" The Board understands that discussions involving the applicant's pension initiative are ongoing among the Applicant and other interested parties. The Board takes no position on the form or specific provisions of such a resolution."

The debtors' business plan is dependent upon the $1.240 billion in exit financing represented by the ASTB guarantee and the RSA investment. The debtors have explored other sources of exit financing but have been unable to identify any other lender or investor willing to provide the cash needed for the debtor to emerge from chapter 11.

Consistent with the commitment in the side-letter to establish a follow-up pension plan, the debtors have proposed, subject to negotiations with ALP A as to the final terms, a defined contribution retirement plan for the active pilots. This plan would provide no benefits to pilots already retired. The preliminary design by the debtors embodies individualized contribution levels based on the number of years each pilot has remaining before reaching retirement age. Those with fewer years remaining would receive significantly higher contributions - in a few cases up to 50% of their pay - in an effort to build up the account to the point where the

retirement benefit, coupled with what the pilot would receive from the PBGC would approach what the pilot would have received under the defined benefit plan.

The maximum insured benefit currently being paid by the PBGC for a person retiring at age 60 - the mandatory retirement age for pilots - is $28,614.00 per year. Depending on when they first became eligible to retire, however, some pilots could receive more, since funds in a terminated retirement plan are used first to pay benefits to "Class 3" participants. The debtors' actuary estimated that the plan was

sufficiently funded to pay approximately 90% of the contractual benefit to Class 3 participants. However, individual cases - as reflected on an exhibit introduced at the hearing - appeared to vary widely, with the projected payments for many of the retired pilots being in the range of one-third to one-half of the amount they would receive under the plan. In one case, for example, a retiree due to receive $211,871 annually would receive only $68,775. Retirees not falling within Class 3 would receive only the insured amount. For a number of the active pilots, even the additional benefit from the proposed follow-on plan would result in a projected benefit of approximately 50% of the benefit that would be paid under the current plan, and even then, only if the follow-on plan achieves the projected 8% rate of return.

A considerable amount of testimony, both on direct and cross-examination, concerned the assumptions utilized by the plan's actuary, as well as the savings that could be achieved if various alternative strategies were pursued. One major issue was the proper discount rate to be used for evaluating plan liabilities for years after 2003. The plan's actuary assumed that certain short-term relief enacted by Congress for years 2002 and 2003 would not be extended when the legislation sunsets at the end of 2003. The relief centers on the discount rate used to

calculate future liabilities. As noted, the lower that rate, the higher the liability. The discount rate in effect before the current relief was 105% of the 4-year weighted average for 30-year Treasury notes, the yields for which are now at a historic low. Thirty-year Treasury notes are no longer being

issued, but apparently the IRS calculates a surrogate for that rate based on yields of existing notes. Under the current relief legislation, the discount rate for current liabilities is calculated at 120% rather than 105% of the 4-year weighted average for 30-year Treasury notes. This has the effect - because it increases the discount rate - of reducing current liabilities, and thus the required contributions the debtors would have to be met. The debtor's actuary testified that he prepared analyses showing the funding contributions that would be required both if legislation were enacted extending the current relief through the seven years of the business plan and if it were not. The debtor's management determined to adopt the more conservative assumption. One of the actuaries testifying as an expert for the retirees stated that he would advise a client of the results under both scenarios and let the client decide which to adopt. The other actuary who testified for the retirees stated that he was certain - and, indeed, could" guarantee" - that Congress would enact legislation extending the 120% standard, or something like it, through the out years of the debtor's business plan. The actuaries differed on the actual effect if the current legislation were extended through the remaining years of the business plan. The two actuaries based their calculations on rules of thumb and rough estimates, while the plan's actuary based his on the actual computer model used for administration of the plan. For that reason, the court finds the calculations of the plan's actuaries more credible. Extension of the current funding relief would result a savings of $115. 9 million in the amount due over the seven years of the

business plan as compared with the amounts due if the current relief expires on its sunset date: 3

Year	2003	2004	2005	2006	2007
Reversion	$25.5	$532	$331.6	$268.7	$216
Extension	25.5	448.5	259.5	254	220
Savings	-	83.5	72.1	14.7	(4.0)

Year	2008	2009	Total
Reversion	$169.5	$68.5	$1,611.8
Extension	$175.8	$112.6	$1,495.9
Savings	$(6.3)	$(44.1)	$115.9

Other issues explored on examination and cross-examination of the actuaries concerned the financial effect of "freezing" the pilots plan, freezing all of the defined benefit plans, and freezing all of the retirement plans (both defined benefit and defined contribution); of retroactively reducing benefits under the various plans; and of splitting the pilots' plan into two plans, one for the retirees and one for the active pilots. Estimates of the amount that could be saved by various combinations of these approaches ranged up to $1.5 billion dollars. The proportion of the pilots' plan that represents obligations owed the retirees, as opposed to the active duty pilots, was estimated to be approximately 25%.

The First Amended Joint Plan of Reorganization filed by the debtors incorporates the revised business plan that was provided to the ATSB in support of the application for the loan guarantee. Under the plan, existing shareholder interests are cancelled, and shareholders receive nothing on account of their equity interest. Unsecured creditors will receive newly issued stock having an estimated value equal to less than two cents on the dollar. A large block of stock will go to the RSA in exchange for its $240 million investment. Other shares will be issued to the various labor groups in exchange for their wage concessions. The plan's

3 Figures are in millions of dollars and reflect only the tax-qualified component of the pilots' plan.

financial projections are based on the RSA investment as well as the $1 billion loan ($900 million guaranteed by the ATSB and $100 million "at risk) to be made at confirmation.

Conclusions of Law and Discussion

A.

This court has subject-matter jurisdiction under 28 U.S.C. §§ 1334 and 157(a) and the general order of reference from the United States District Court for the Eastern District of Virginia dated August 15, 1984. Under 28 U.S.C. § 1 57(b)(2)(A), this is a core proceeding in which a final order may be entered by a bankruptcy judge. Proper notice of the motion and of the hearing were given to the PBGC, ALPA, and all beneficiaries of the pilots' plan. Vigorous objection was raised by many of the objecting parties that 20 days notice, even if technically sufficient under the Federal Rules of Bankruptcy Procedure and the case management order entered in this case, was wholly inadequate as a practical matter, given the complexity of the financial issues. The court was not unsympathetic to that argument but concluded that the circumstances simply did not permit the hearing to be put off and required that the motion be promptly decided. In any event, the record reflects that the objecting parties, notwithstanding their limited opportunity to prepare, were fully able to develop the record and present their cases.

B.

The pilots retirement plan is subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), which, among other things, establishes certain funding standards for defined benefit plans and provides an insurance program under which the PBGC will

administer an underfunded pension plan that is terminated. Termination of such a plan by the

employer is governed by 29 U. S. C. § 1341, which addresses both a "standard" termination and a "distress" termination. It is the latter which the debtors' seek to accomplish.

In order to effect a distress termination, the plan administrator must give the PBGC and each affected party at least 60 days written notice of intent to terminate setting forth the proposed termination date. 29 U. S.C. § 1341(a)(2). Additionally, the termination must not violate the terms and conditions of an existing collective bargaining agreement. 29 U. S.C § 1341(a)(3). For a chapter 11 debtor, the standards for a distress termination require that four condition be met:

> 1. As of the proposed termination date, the employer has filed, or has had filed against it, a petition for reorganization under the Bankruptcy Code;
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> 2. The case has not, as of the proposed termination date, been dismissed;
>
> 3. The employer has provided the PBGC any request for Bankruptcy Court approval of the termination; and

> 4. The bankruptcy court determines that, unless the plan is terminated, the employer will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process and the court approves the termination.

29 U. S. C.. § 1341(c)(2)(B)(ii)(I) - (IV). The statute requires the debtor to make a showing that it will be unable to pay all of its debts under a plan of reorganization and will be unable to continue in business outside of bankruptcy. *In re Wire Rope Corp. of America, Inc.,* 287 B.R. 771,777 (Bankr. W.D. Mo. 2002). The purpose of the statute

is to limit "to cases of severe business hardship" the ability of plan sponsors to terminate their pension plans and thereby shift liability for guaranteed benefits onto other insurance premium payers in the PBGC program.

!d. The reference in the statute to "a" plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan. 287 B.R. at 777-78. The burden of proof for a distress termination is on the sponsor of the plan. 287 B.R. at 777.

The debtors assert that, absent termination of the plan, they will be unable to obtain confirmation of the reorganization plan they have proposed. They also assert that the December 13, 2002, side letter constituted an assent by ALP A to a distress termination if pension funding relief could not be obtained from the PBGC and ALP A, and they seek a ruling that a distress termination would not violate the

collective bargaining agreement. Finally, they seek authority to enter into a follow-on defined contribution plan for the pilots on terms consistent with those set forth in the side letter.

The objecting parties contend that the debtors have simply not made an adequate showing that reasonable alternatives to plan termination have been properly considered or explored. They also dispute that the funding shortfall is as great or as unmanageable as the debtors have portrayed. They argue that plan termination would have a devastating effect on the pilots in general, especially on the retirees (who would receive no benefits from the follow on plan), and is highly unfair given that only the pilots' plan would be terminated, while all the remaining employee groups would keep their current pension benefits. Finally, they argue

that ALP A never consented to a distress termination of the plan; that termination would violate the collective bargaining agreement; that in any event under the Railway Labor Act this court has no jurisdiction to make that determination; and that the court should not even consider approving the termination until the pending grievances are resolved.

C.

The pivotal issue to be resolved by the court is whether the financial requirements for a distress termination have been met. As the court observed in ruling from the bench, the very fact that this issue is before the court is disheartening, to say the least. At the outset of this chapter 11 case, the

debtors announced that they intended to pursue a "labor-friendly" reorganization. There is no dispute that the pilots have already given up more in pay and benefits than any other employee group. This is true not only in gross dollar terms but also as a percentage of the targets that each group was asked to give. Under the present motion, the only pension plan that would be terminated is the pilots' defined benefit plan. It is not surprising, therefore, that the pilots, whether active or retired, feel a particularly keen sense of having been shabbily treated.

The problem, however, is simply the magnitude of the funding obligation for the pilots' plan, which dwarfs that of the other plans. As noted, the funding requirement for the pilots' plan over the seven years of the business plan is fully two-thirds of the amount for all four of the company's defined benefit plans (one of which has been "frozen" since 1991) combined. In simple dollar terms, terminating any of the other defined benefit plans would not solve the cash flow obstacles to the debtors' reorganization.

17

The statutory test, as noted, is whether "unless the plan is terminated, the employer will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process." 29 U.S. C. § 1341(c)(2)(B)(ii)(N). The only plan of reorganization that has been identified as being in any sense realistic is the plan proposed by the debtor and approved by the A TSB. It "pays" unsecured creditors only in stock having an estimated value of less than two cents on the dollar. The Official Committee of Unsecured Creditors has

nevertheless recommended acceptance of the plan. Even this marginal payout is wholly dependent upon the debtors' obtaining the $1.240 billion in exit financing represented by the $1 billion ATSB-guaranteed loan and the $240 million RSA investment. The testimony of the debtors' financial advisor is that without a "resolution" of the pension funding issue that will enable the reorganized debtors to meet the projections in their business plan, the A TSB is unlikely to issue its guarantee and RSA is unlikely to make its investment. The debtors have explored other sources of exit financing and but have been unable to identify any other lender or investor willing to provide the cash needed for the debtor to emerge from chapter 11. Indeed, without the ability to draw down on the remaining $200 million in DIP financing, it is questionable whether the debtor can continue to operate in chapter 11. No "resolution" of the pension funding issue has been identified by the debtors other than restoration funding or termination of the pilots' plan. Restoration funding is wholly dependent upon Congress enacting legislation to provide such relief, and no such legislation is currently pending. That leaves only termination.

18

The objecting parties assert, however, that there are other solutions, or at least potential solutions, which the debtors have failed adequately to explore. These include "freezing" the pilots' plan, splitting the pilots' plan into separate plans for retirees and active pilots, freezing the company's other pension plans, and retroactively reducing the benefits under the company's other pension plans. Based on the evidence presented at the hearing, however, the court was not convinced that any of these alternatives were realistic, especially given that modifications to the various plans,

whether defined benefit or defined contribution, for the debtor's other labor groups would require either the agreement of the unions involved or the rejection of the collective bargaining agreements with those unions. As reflected by the debtors' limited success in obtaining second-round concessions from the unions other than ALP A, the likelihood that, for example, the mechanics and the flight attendants - whose pay and pensions are far below that of the pilots - would agree to a freezing or retroactive reduction in their pension benefits so as to preserve the pilots' benefits verges on fantasy. Moreover, time is running out. It was testified that the debtors' agreement with their Visa/Mastercard credit card processor expires March 31, 2003, and apparently will not be extended in any event beyond May 1, 2003. Approximately have the debtors' ticket revenues come from credit card sales. Although the debtors have negotiated with other credit card processors to take the existing processor's place, those processors have stated that emergence from chapter 11 is a condition of entering into any agreement.

The court determines, therefore, that the debtors have carried their burden of showing that, unless the pilots pension plan is terminated, the debtors will not be able to pay their debts under a plan of reorganization and will not be able to continue in business outside the chapter

11 reorganization process. Only one realistic plan of reorganization has been proposed. It is dependent on the $1.240 billion in exit financing represented by the ATSB $900 million loan guarantee, the associated $100 million in

"at risk" loans, and the RSA $240 million capital contribution. Those in turn are dependent on the debtor's ability - and more precisely on ATSB's and RSA's comfort that the debtors have the ability - to meet in each year the levels of profitability reflected in the seven-year business plan. No other source of exit financing has been identified, and without the A TSB guarantee and the RSA investment, there is no apparent way the debtor will be able to emerge from chapter 11 and avoid liquidating under chapter 7.

D.

The next issue is whether the court should "approve" the termination. No reported case appears to have discussed what showing, if any, must be made for approval beyond a finding that the debtor meets the financial requirements set forth in the statute. The court nevertheless will assume that the court, in deciding whether to approve a distress termination, may consider other equities in the case.

As will be discussed, there remains an issue of whether termination of the pilots' pension plan would violate the terms of the collective bargaining agreement between ALPA and the debtors. However, again for reasons that will be discussed, this court does not have jurisdiction to decide that issue. Accordingly any approval by this court is necessarily subject to a separate determination that termination will not violate the collective bargaining agreement.

The remaining argument is that termination of the pension plan result in serious financial hardship to many, and perhaps most, of the active and retired pilots and their

families. From the evidence presented as well as the numerous letters the court has received, it is obvious that many individuals will indeed suffer great financial hardship. But the question always remains: what is the alternative? If the debtors are unable to reorganize and must liquidate in chapter 7, the pension plan would be terminated anyway, and the retired pilots would be in exactly the same position, as regards their pension, as they will under the proposed distress termination. The position of the active pilots would be significantly worse under a liquidation, because they would also lose their current employment and whatever benefits might accrue under a follow-on plan. Given that reality, the undoubted financial hardship that will result from a termination of the plan is an insufficient basis for this court to withhold its approval when the debtors have made a compelling showing that termination is necessary for this airline to emerge from chapter 11.

E.

The final issue is whether a distress termination of the plan would violate the collective bargaining agreement between the debtors and ALP A. There is no dispute that the maintenance of the plan is required by the collective bargaining agreement, which has not been rejected and indeed which the chapter 11 plan proposes to assume. The debtors, however, contend that the December 13, 2002, side letter which was demanded by ALP A as a condition of agreeing to the second-round of concessions constitutes ALP A's consent to a distress termination if the debtors and ALP A were unsuccessful in obtaining funding relief from the PBGC or the IRS. ALP A, on the other hand, asserts that it never agreed to such a termination by the debtors but simply recognized that the PBGC was not bound by the collective bargaining agreement and had the power to step in and

terminate the plan. The purpose of the

letter, according to ALPA's evidence, was simply to provide a measure of protection in the event the PBGC acted on its own initiative.

The language in the side letter could fairly be characterized as equivocal. It begins, "If the PBGC and the IRS reject the Company's request for long-term funding relief *and this results* in termination of the plan. . . ." (Emphasis added). Standing alone, the term "termination" might refer either to a distress termination or an involuntary termination. At the same time, the phrase" and this results" strongly tends to suggest outside action rather than action by the company. It is true that some of the testimony given by the president of ALPA at the Congressional hearing in January 2003 could be interpreted as acknowledging the debtors' right to initiate a distress termination if agency or legislative relief were not obtained. Balanced against this, however, is the testimony of the head of the pilots negotiating committee that the side letter was not intended to allow the debtors, as opposed to the PBGC, to terminate the plan without ALPA's approval. Indeed, given that ALPA had already, as part of the second round of concessions, agreed to very specific changes in the pension plan, it would seem strange that the union would, in a side agreement, essentially give the debtor carte blanche to go ahead and terminate the plan. In any event, having considered the evidence, the court can only conclude that reasonable finders of fact could reach differing conclusions as to the meaning of the side letter, and, specifically, as to whether it authorized the debtors to proceed with a distress termination of the plan.

It is precisely because reasonable persons could disagree as to the interpretation of the side letter that the court declines to reach that issue. As ALPA persuasively argues, the Railway Labor Act, 45 U. S. C. § 151 *et seq.*, which also governs collective bargaining

agreements in the airline industry, *see* 45 U. S. C. § 181, divests federal courts of jurisdiction over so-called "minor" disputes as to the interpretation and application of collective bargaining agreements, 4 which instead must be determined by boards of adjustment established under the agreement itself. 45 U. S.C. § 184; *United Transp. Union* v. *South Carolina Pub. Ry.Comm 'n,* 130 F.3d 627 (4th Cir. 1997) (citing *Consolidated Rail Corp.* v. *Railway Labor Executives Ass'n.,* 491 u.S. 299, 109 S.Ct. 2477, 105 LEd.2d 250 (1989)); *Air Line Pilots Ass'n, Intern.* v. *Northwest Airlines, Inc.,* 627 F.2d 272 (D.c. Cir. 1980) (district court lacked subject matter jurisdiction over dispute between airline and union as to alleged violation of collectively bargained pension plan). This is true even as to an airline in bankruptcy. *In re Continental Airlines,* 125 F.3d 120, 129 (3rd Cir. 1997) (role of federal court is to protect the jurisdiction of the arbitral board; court cannot inquire into the merits of the underlying dispute under the collective bargaining agreement); *see also In re Ionosphere Clubs, Inc.,* 922 F. 2d 984 (2d Cir. 1990) (debtor is bound by the arbitration provisions of the collective bargaining agreement until the agreement is rejected under § 1113, Bankruptcy Code).

Here, there is no dispute that a system board of adjustment has been established under the collective bargaining agreement between the debtor and ALP A to

resolve disputes under the agreement. The court will assume that it has discretion, in matters falling within its "core" jurisdiction, to determine whether to stay its own proceedings in favor of arbitration.

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4 As the Fourth Circuit has explained, "minor" disputes under the Railway Labor Act "involve 'either... the meaning or proper application of a particular provision [of a collective agreement] with reference to a specific situation or to an omitted case.. . . ", *Dement* v. *Richmond, Fredericksburg & Potomac R.R. Co.,* 845 F.2d 451,462 (4th Cir. 1988) *(citing Elgin, J & E. Ry. Co.* v. *Burley,* 325 U.S. 711, 65 S.Ct. 1282, 89 LEd. 1886 (1945)).

Gandy v. *Gandy (In re Gandy),* 299 F. 3d 489, 495 (5th Cir. 2002); *In re U.* S. *Lines, Inc.,* 197 F.3d 631, 640 (2nd Cir. 1999). However, in a case in which a fair argument can be made for each party's interpretation of the agreement, the court concludes that the firm and long standing policy under the Railway Labor Act of deferring to the arbitration mechanisms established by the Act precludes this court from reaching the merits of the dispute. For that reason, the court declines to make a finding, as the debtors have requested, that a distress termination would not violate the terms of the collective bargaining agreement. Any such ruling must be made by the System Board of Adjustment established under the collective bargaining agreement.

F.

One final matter requires only brief discussion. ALP A and several of the individual objectors assert that the debtors are attempting to have this court "impose" a particular form of defined contribution plan upon the pilots. The debtors have disclaimed any intent to have this court decree the details of a follow-up plan (assuming the present plan is terminated) or to impose it on the pilots. The debtors say they simply seek authorization from the court to enter into a follow-up plan on such terms, consistent with the December 13, 2002, side letter, as may be negotiated with ALPA. That is the court's understanding of the motion as well. Granting the debtors authority to enter into a defined contribution plan for the pilots does not compel the pilots to accept any particular form of plan and does not allow the debtor to impose particular plan terms on the pilots. It simply eliminates the need for the debtor to return to this court for approval of a follow-up plan provided the plan does not cost more than the debtor would have paid under a restoration funding approach (and is already accounted for in

the financial projections supporting the plan of reorganization) and provided the plan is otherwise non-objectionable to the IRS and the PBGC.

Conclusion

In summary, the court finds that the financial requirements for a distress termination have been met, and the court has approved such termination provided the

termination does not violate the terms of the collective bargaining agreement between the debtors and ALP A. The court declines to make a ruling on that issue, and that dispute will have to be resolved under the arbitration mechanism established by the collective bargaining agreement pursuant to the Railway Labor Act. The court further concludes that the debtors should be allowed, if the existing pension plan is terminated, to enter into a follow-on defined contribution plan upon such terms as may be negotiated with ALP A without having to return to this court provided the cost of the plan does not exceed the amount the debtor would have paid under a restoration funding approach.

An order has previously been entered consistent with this opinion.

Date: March 7, 2003

s/ Stephen S. Mitchell
United States Bankruptcy Judge

Alexandria, Virginia

U.S. Supreme Court

PROTECTIVE COMMITTEE v. ANDERSON, 390 U.S. 414 (1968)

390 U.S. 414

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC. v. ANDERSON, TRUSTEE IN BANKRUPTCY, ET AL. CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT. No. 38.

Argued November 7-8, 1967.
Decided March 25, 1968.

TMT Trailer Ferry, Inc. (TMT), the debtor in this protracted reorganization proceeding, was incorporated in 1954, and engages in transporting loaded truck trailers and other freight between Florida and Puerto Rico on sea-going barges. TMT incurred substantial debts and losses from the unsuccessful conversion of a Navy LSD by a drydock and repair company (M-S). Between 1954 and 1957 TMT issued more than 4,000,000 shares of common stock, many of which were acquired by insiders at low prices and disposed of to the public in alleged violation of the Securities Act of 1933 at relatively high prices. As a result of these and other transactions TMT became unable to meet its obligations and a reorganization proceeding was started by an involuntary petition filed against TMT in June 1957. In 1959 the District Court, solely on the basis of documents and records and without a hearing, declared TMT insolvent. It held that the original stockholders had no further interest in the reorganized company, and confirmed a reorganization plan which would have given control of TMT to the holders of preferred ship mortgages on TMT's vessels (the "Caplan mortgage") even though the District Court had questioned, and the trustee (respondent Anderson) had objected to, the

validity of the claims. A successor trustee thereafter petitioned in effect that the order confirming the plan be vacated because of an allegedly illegal agreement between the Caplan mortgage holders and M-S. The petitioner Committee appealed, objecting to the trial court's failure to make an investigation and to conduct a hearing on insolvency. The SEC then petitioned the trial court to investigate its claims that the plan was unfair. The parties agreed on an investigation, which respondent Anderson as reinstated trustee conducted. Anderson's investigation concluded that TMT's business had been "wrecked by gross mismanagement" and "unsound expansion," that TMT [390 U.S. 414, 415] had substantial causes of action against the principal Caplan mortgage holders for diverting corporate opportunities through flagrant abuse of their control and inside positions, and that the mortgage was "a fraudulent transfer not given for fair consideration." Thereafter the trial court vacated its order confirming the 1959 plan and the Court of Appeals affirmed. After the trial court set aside the 1959 plan, no hearings were held on the trustee's and the SEC's objections to the Caplan mortgage claim. The mortgage was not set aside as a fraudulent transfer, nor was it decided to use the claims against the Caplan mortgage holders as setoffs. The SEC, which contended after its own investigation that there were grounds for disallowing the M-S claims, filed detailed specifications of its objections to those claims based upon M-S' alleged negligence and other factors. The SEC and trustee sought reference of the M-S claims to a master but later the trustee moved for the allowance of the claims on the ground that there was only a "remote" possibility of materially reducing them. Despite his own doubts, and without further investigation, the trial judge ultimately confirmed the M-S claims in full as unsecured claims. In 1962 two new reorganization plans were proposed: the "internal plan," recommended by Anderson, involving issuance of new common stock to creditors and "compromises" of (1) the Caplan mortgage whereby the

mortgage holders were to receive in cash what they had put up for the mortgage, plus interest on the principal from the original due date, and (2) the M-S claims whereby they were also allowed in their full amount as unsecured claims, under an arrangement whereby M-S would receive 40% of the reorganized company's common stock; and the "cash plan" involving similar "compromises" and selling the debtor's assets for cash to persons unconnected with the company, the cash to be distributed to creditors. The Committee and the SEC objected, inter alia, that TMT's stockholders were excluded from both plans. Following valuation hearings which did not include full testimony about the company's future prospects, the District Court concluded that its going-concern value, based on current earnings, was $2,780,000. Since creditors' claims were almost twice that much, the court found the debtor to be insolvent and excluded TMT's stockholders from participation in the reorganized company. The District Court approved both plans, observing in connection with "compromising" the Caplan mortgage and M-S claims that successful litigation against the claimants "would take possibly years to conclude" and holding the compromises [390 U.S. 414, 416] "fair and equitable" under the circumstances. A majority of all classes of creditors accepted the internal plan, which that court confirmed in February 1963. The Court of Appeals remanded the case to the District Court to determine the feasibility of the plan if the Government's nontax claims were given priority, which it held was required. The District Court, after hearings, approved the plan as amended to include an immediate cash payment to the Government and assumed that the Court of Appeals had in effect affirmed its other orders and, refusing to reconsider the Committee's and SEC's contentions with regard to the Caplan mortgage and M-S claims, affirmed the plan, which the creditors had accepted. The Committee again appealed. The Court of Appeals ruled that its earlier decision left open all issues not previously discussed or decided but, finding no abuse of

discretion or clear error, refused to remand the case and affirmed all judgments and orders of the District Court, stating that "[t]his . . . litigation must at long last be brought to an end." Dealing with the District Court's approval of the compromises in five sentences, the Court of Appeals noted that "not a single creditor has ever complained of either compromise." Held:

> 1. The Court of Appeals erred in affirming the District Court's approval of compromises involving substantial recognition of the claims against the debtor filed by the Caplan group and M-S in view of the inadequacy of the record for assessing the fairness of the proposed compromises. Pp. 424-441.
> (a) A bankruptcy judge has the duty of determining that a proposed compromise forming part of a reorganization plan is fair and equitable; he must ascertain all facts necessary to determine the probabilities of success should claims be litigated. P. 424.
> (b) The record here provides a reviewing court with no basis for distinguishing between well-reasoned conclusions of the trial court and mere conclusory language unsupported by evaluation of the facts or analysis of law. P. 434.
> (c) An unfair reorganization plan may not be approved by a bankruptcy court even though the vast majority of creditors have approved it. P. 435.
> (d) Approval of compromises is more questionable when the available facts indicate the inadvisability of compromise than when there are no facts pointing either way. P. 436.
> (e) The facts in the record indicate the probable existence of valid and valuable causes of action, and since there were no [390 U.S. 414, 417] facts permitting a reasoned judgment that these claims should be compromised as the plan provides,

approval of the compromises was not justified. Pp. 438-441.

2. The District Court erred in relying upon only the debtor's past earnings in determining its value as a going concern. Without having evidence relating to the debtor's future prospects, the court could not assess its going-concern value or properly determine that the debtor was insolvent. Pp. 441-453.

(a) Whether a reorganization plan excluding junior interests (here stockholders) meets the statutory requirement that the plan be "fair and equitable" depends upon the value of the reorganized company. Since the District Court did not apply the proper valuation standards, its determination of insolvency was improper and the reorganization plan cannot stand. P. 441.

(b) The valuation of a company undergoing reorganization must include an estimate based on an informed judgment embracing all facts relevant to future earning capacity. P. 442.

(c) The value of the debtor's business depended "not on the inherent value of its assets but primarily on maintaining a high level of earnings." P. 443.

(d) The trial judge's steadfast refusal to consider the company's value once it was out of the reorganization proceedings constituted an error which infected his conclusion that the debtor was insolvent. P. 444.

(e) In the circumstances of this case, which involve a company which had established and increased its share of a highly competitive market despite intense competition and major internal crises, an adequate notion of its going-concern value required looking to the future as well as the past. P. 446.

(f) The information introduced at the two insolvency hearings was inadequate for even a rough evaluation of TMT's future prospects, a situation which resulted

from the trial judge's hostility to evidence concerning the company's future. Pp. 447-451.

364 F.2d 936, reversed and remanded.

Irwin L. Langbein argued the cause for petitioner. With him on the briefs was Irma S. Mason.

William P. Simmons, Jr., argued the cause and filed a brief for respondent Anderson. M. James Spitzer [390 U.S. 414, 418] argued the cause for respondents Shaffer et al. With him on the brief were Ronald J. Offenkrantz and Jackson L. Peters.

David Ferber, by special leave of Court, argued the cause for respondent Securities and Exchange Commission. With him on the briefs were Solicitor General Griswold, Ralph S. Spritzer, Daniel M. Friedman, Philip A. Loomis, Jr., and Paul Gonson.

MR. JUSTICE WHITE delivered the opinion of the Court.

This case involves a corporate reorganization under Chapter X of the Bankruptcy Act, 52 Stat. 883, 11 U.S.C. 501-676. In the most recent proceedings 1 the District Court approved an amended plan of reorganization and discharged the petitioner Committee. 2 The Court of Appeals for the Fifth Circuit affirmed, 364 F.2d 936 (1966). We granted certiorari, 387 U.S. 929 (1967), because this case presents important questions under the bankruptcy laws. Since we believe the Court of Appeals erred in affirming the decision of the District Court, we reverse the judgment and remand for further proceedings consistent with the views expressed below. [390 U.S. 414, 419]

I.

The debtor, TMT Trailer Ferry, Inc., was incorporated in 1954. Its principal business is transporting freight between Florida and Puerto Rico. It pioneered "fishyback" transport, the ocean-going equivalent of "piggyback" transport. Freight loaded into highway trailers is rolled on and off sea-going barges without rehandling. In its original operations TMT used rented tugs to tow converted Navy LST's loaded with such trailers and other freight. Later it undertook to convert a self-propelled Navy LSD for use in its business. Substantial debts and losses arose from the unsuccessful conversion and consequent failure in service of this ship, dubbed the Carib Queen.

In addition, between 1954 and 1957, more than 4,000,000 shares of TMT common stock were issued, many of them acquired at low prices by persons close to the company and disposed of to the public at relatively high prices. As a result of these transactions and others, TMT became unable to meet its obligations, and a reorganization proceeding was initiated against it by involuntary petition in June 1957. The debtor consented to reorganization, and C. Gordon Anderson was appointed trustee. The motion of the holders of preferred ship mortgages on the debtor's vessels (the Caplan mortgage) to foreclose their liens was denied by the trial court. On appeal from this order, it was pointed out that no plan of reorganization had yet been proposed, that the possibility of successful reorganization had not been explored, and that no evidence had been received to support any of the court's orders. The Court of Appeals reversed and remanded with instructions that the holders of the Caplan mortgage be permitted to foreclose unless adequate provision was made to protect their interests or unless they would not be prejudiced by further delay. [390 U.S. 414, 420]

Upon remand the trial court held appropriate hearings. It was determined that the debtor was being operated in a manner which would produce substantial profits. A plan of

reorganization was proposed which would have given the Caplan mortgage group all the common stock in the reorganized company, a substantial portion of the preferred stock, and control of the board of directors. In February 1959, without a hearing called for that purpose and solely on the basis of documents and records, the trial court declared the debtor insolvent and held that the original stockholders had no further interest in the reorganized corporation. In March 1959 the plan of reorganization was confirmed, and Anderson resigned as trustee to become president of the reorganized company. A new trustee was appointed, and he sought in effect to vacate the order confirming the plan. His petition alleged that the holders of the Caplan mortgage and Merrill-Stevens Dry Dock & Repair Co. (M-S), another substantial creditor, had entered into an undisclosed agreement in violation of 221 of Chapter X, 52 Stat. 897, 11 U.S.C. 621, an agreement according to which the Caplan mortgage group would pay M-S in order to procure its consent to the plan of reorganization. This petition was denied, the successor trustee wasremoved, and Anderson was reinstated as trustee.

The petitioner Committee appealed from the order confirming the reorganization plan. Objection was made to the failure of the trial court to order an investigation into the claims of certain creditors and to the failure to conduct a hearing on insolvency. While that appeal was pending, the Caplan group, supported by Anderson, petitioned the trial court to consummate the confirmed plan. The Securities and Exchange Commission, however, filed a petition in the trial court seeking an investigation. 3 It [390 U.S. 414, 421] alleged that an investigation would disclose that the plan was unfair because it turned the corporation over to persons who had dealt extensively in the stock of the debtor in transactions which were probably illegal. It was agreed among the parties that an investigation should be made.

Anderson, in his re-established role as trustee, conducted the investigation. Fourteen days of hearings were held, 2,200 pages of testimony transcribed, and some 60 exhibits collected. Anderson's report from this investigation covers 40 pages in the original record. He concluded that the debtor's business had been "wrecked by gross mismanagement, by unwise and unsound expansion financed primarily through the sale of securities in disregard of the protective provisions of the Securities Act of 1933," and that the debtor had substantial causes of action against holders of the Caplan mortgage. Upon the recommendation of Anderson, the trial court vacated its order confirming the 1959 plan, and the Court of Appeals affirmed. 4

Early in 1962 two new plans of reorganization were proposed. The "internal plan," recommended by Anderson, provided for reorganizing the debtor by issuing new common stock to creditors and involved "compromises" of the Caplan mortgage and M-S claims. The "cash plan" entailed similar "compromises" as well as selling the debtor's assets for cash to persons unconnected with the company and distributing the cash [390 U.S. 414, 422] to creditors. Neither plan provided for any participation by stockholders. The Committee, supported by the SEC, objected to the exclusion of stockholders from both plans, and opposed the internal plan because it contemplated that Anderson would become president of the reorganized company. After hearings on valuation, the District Court found the debtor insolvent and approved both plans as fair, equitable, and feasible. A majority of all classes of creditors other than the United States accepted the internal plan, and the District Court confirmed it in February 1963. The Committee appealed, supported by the SEC, arguing that the plan wrongly excluded stockholders and improperly contemplated that Anderson would become president. The Court of Appeals ruled, without reaching the other contentions, that it was permissible for the plan to contemplate that Anderson would

become president, 5 but it held in a separate appeal that the plan was defective for not giving priority to the Government's nontax claims. 6 The case was accordingly remanded to the District Court for determination of whether the plan would be feasible if the Government's claims were given full priority.

On remand further hearings were held, the District Court found that if the Government's nontax claims were given priority the plan would be feasible, and amendments were authorized which provided for immediate cash payment to the Government. The court regarded the failure of the Court of Appeals to reverse its other orders as in effect an affirmance of them, and it refused to consider again the contentions of the Committee and the SEC. The creditors accepted the amended plan and, over the objections of the Committee and the SEC that the plan was not fairor equitable, the District [390 U.S. 414, 423] Court affirmed it. The Committee again appealed, and the Court of Appeals ruled that its earlier decision had left open all issues not in terms discussed and decided. 7 Passing over the fact that the District Court had considered the case in erroneous legal perspective, and emphasizing that its obligation was to determine whether the trial judge had "abused his discretion" or reached conclusions which were "clearly erroneous," the Court of Appeals refused to remand the case. Stating that "[t]his . . . litigation must at long last be brought to an end," the Court of Appeals affirmed all judgments and orders of the District Court. The Committee, again supported by the SEC, has presented a number of questions on certiorari to this Court. 8 Because of the view we take of this case, it is necessary to consider only the questions of whether it was error to affirm the District Court's approval of compromises of substantial claims against the debtor, and whether it was error to affirm the District Court's judgment that the debtor was insolvent, when that judgment was rendered without

considering the future estimated earnings of the reorganized company. [390 U.S. 414, 424]

II.

Compromises are "a normal part of the process of reorganization." Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 130 (1939). In administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts. At the same time, however, it is essential that every important determination in reorganization proceedings receive the "informed, independent judgment" of the bankruptcy court. National Surety Co. v. Coriell, 289 U.S. 426, 436 (1933). The requirements of 174 and 221 (2) of Chapter X, 52 Stat. 891, 897, 11 U.S.C. 574, 621 (2), that plans of reorganization be both "fair and equitable," apply to compromises just as to other aspects of reorganizations. Ashbach v. Kirtley, 289 F.2d 159 (C. A. 8th Cir. 1961); Conway v. Silesian-American Corp., 186 F.2d 201 (C. A. 2d Cir. 1950). The fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable. In re Chicago Rapid Transit Co., 196 F.2d 484 (C. A. 7th Cir. 1952). There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.

Basic to this process in every [390 U.S. 414, 425] instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation. It is here that we must start in the present case.

The Caplan mortgage, consisting of preferred ship mortgages on the debtor's vessels, bears a face amount of $330,000. The holders paid $280,500 for it. Under the proposed compromise, the holders would receive $280,500 paid in five annual cash installments, plus interest from the original due date. 9 The claims filed against the debtor's estate by M-S totaled $1,628,284, of which $574,580 was said to be secured by maritime liens on the debtor's vessels. Under the terms of the compromise, these claims are to be allowed in full, after reducing them all to the status of unsecured claims. As with other unsecured claims, they would be paid for by issuing common stock in the reorganized company. M-S would wind up holding approximately 40% of the stock in the new company. 10 A glance at these terms makes it clear that the compromises involve substantial recognition of the claims filed by the Caplan group and M-S against the debtor. Whether compromising on these terms was fair and equitable to the debtor, the other creditors, and the stockholders depends upon the proper assessment of the claims which the debtor allegedly had against both the Caplan group and M-S.

The Caplan mortgage was the focal point of the 1960 investigation conducted by the trustee, Anderson. The [390 U.S. 414, 426] mortgage was entered into shortly before the petition in bankruptcy was filed. It was needed to raise cash to meet payments due on the Carib Queen. After an extensive investigation, Anderson concluded that the mortgage was a fraudulent transfer not given for fair consideration. Anderson's report succinctly stated the unfairness of the terms of the mortgage:

> "The Caplan Group paid $280,500 cash for the mortgage to TMT which paid all of the expenses of the transaction. The mortgage was for $330,000 payable in seven months and is convertible into common stock at the option of the holders, one share of common for each $1.25 of principal amount of the mortgage. This gave the Caplan Group an effective interest rate of 30% per annum prior to maturity and an opportunity to straddle because of the conversion feature. If TMT prospered, they could convert the mortgage into common stock for which they would have paid little more than $1.00 per share; if TMT did not, the Caplan Mortgage was in a senior position and constituted a lien on TMT's prime assets, absolutely necessary to the Company's operation. Since the Carib Queen had broken down, the vessels encumbered by the mortgage were the main producers of income for the company."

Anderson found that there was "ample evidence" to support this view of the mortgage, and that therefore the mortgage should be treated as null and void. So treating it would not release TMT from the obligation to repay the money received, but in claiming that amount the holders of the mortgage would have no higher status than general unsecured creditors. 11 [390 U.S. 414, 427].]

In addition, Anderson's report concluded that the principal holders of the Caplan mortgage, Abrams, Shaffer, and Erdman, had diverted corporate opportunities through the flagrant abuse of their control, fiduciary or inside positions, and should be made to account for the profits they had made. Nearly half of the roughly 4,000,000 shares of outstanding TMT common stock reached the public via purported private offerings through Abrams and Shaffer. These two men exercised a high degree of control over the affairs of the company, and Erdman went along with them and participated in many of their transactions. Anderson found

that these three occupied a fiduciary relationship with TMT, at least insofar as issuance of capital stock to them was concerned. "They took advantage of their inside position to obtain stock for less than the market price which they sold to the public without any registration under the Securities Act and in apparent violation of the private offering exemption under which all of the stock was issued." The activities of these three men substantially lessened TMT's chances of obtaining financing from reputable financial institutions "and by the time the Caplan mortgage was executed they were in a position to dictate terms which TMT would be forced to accept." Anderson's report continued:

> "It is the opinion of the trustee that persons such as Abrams, Shaffer and Erdman who come in as creditors of TMT under the Caplan Mortgage . . . should be barred in this equity proceeding from profiting at TMT's expense. Their claims should be reduced by the profits they have made on sales of TMT stock which they acquired for private investment [390 U.S. 414, 428] purposes, but which they sold in violation of the law at great profit to themselves. These profits are either admitted or readily ascertainable and should be returned to the company."

Characterizing the conduct of Abrams, Shaffer, and Erdman in acquiring unregistered TMT stock with no intention of holding it for investment as a "fraud," Anderson indicated the possibility of liability under the SEC's Rule 10b-5. 12 Anderson said that at a minimum their claims should be subordinated to those of innocent creditors. 13

As a result of the report filed by trustee Anderson, the order confirming the 1959 plan of reorganization was vacated. Both the trustee and the SEC filed objections to the Caplan mortgage claim, grounded on the reasons presented in the report of the investigation. The District Court never held

hearings on these objections. The mortgage was not set aside as a fraudulent transfer, nor was it decided to use the claims against Abrams, Shaffer, and Erdman as setoffs or as a means of subordinating the mortgage claims. Rather, the internal plan of reorganization was approved by the District Court, providing for a "compromise" of the Caplan mortgage along the lines already indicated. The holders of the mortgage were to receive in cash what they had put up for the mortgage, plus interest on the principal from the original due date. 14

Separate from the Caplan mortgage claims were the claims filed by M-S, the company in charge of converting [390 U.S. 414, 429] the Navy LSD into the self-propelled trailership which TMT christened the Carib Queen. These claims totaled $1,628,284, of which over $1,000,000 was for the unpaid balance due for converting the Carib Queen. Maritime liens on other vessels owned by TMT allegedly secured $574,580 worth of these claims. The United States, in its position as a substantial creditor of TMT, filed objections to M-S claims, stating that none of them were entitled to status as secured claims "for the reason that they arose more than one year prior to the commencement of the reorganization proceedings herein." It also contended that the claims had no status as secured lien claims, for "it is a recognized principle of Admiralty and Maritime law that claims for the conversion or reconstruction of vessels do not give rise to Maritime liens." Whether the portion of the claims for which M-S asserts secured status is actually entitled to that status has never been determined. The "compromise" of the M-S claims amounted to allowing them in their entirety as unsecured claims.

On the maiden voyage of the Carib Queen a series of boiler failures caused the vessel to break down and necessitated extensive repairs. In November 1958 the petitioner Committee notified the District Court that in its opinion the

"series of catastrophes" which had befallen the Carib Queen was due to "faulty design, inadequate inspection, defective work on the remodeling and later repair of the ship, hasty and improper preparations for a hazardous sea voyage and utilization of the ship in a service for which she was not fitted and in an unseaworthy condition." The Committee thought that TMT had causes of action which could lead to the recovery of substantial sums of money. Although Anderson's report on his subsequent investigation of the affairs of TMT dealt with causes of action other than those associated [390 U.S. 414, 430] with the Caplan mortgage, it made no mention of any claims TMT might have against M-S. The SEC objected to the M-S claims, stating that there were grounds for disallowing them and that the matter should be referred to a special master for investigation. Trustee Anderson also sought reference of these claims to a special master. On September 1, 1961, the SEC filed detailed specifications of its objections to the M-S claims, based on its own investigation into them. The SEC stated that the debtor.

> "has meritorious defenses and an offset or counter-claim because M-S (a) did not properly convert the vessel; (b) did not comply with the terms of the contract; (c) did not properly repair the vessel; and (d) performed certain work for and furnished certain materials to TMT, with no agreement as to price; M-S has failed to establish the value of such work and materials."

The SEC described with some particularity the facts which had led it to this conclusion. The most important of these related to the boiler failure which occurred shortly after M-S delivered the Carib Queen for its maiden voyage. Within 48 hours of sailing from Jacksonville, Florida, bound for San Juan, Puerto Rico, it was discovered that a boiler and several tubes were leaking. Tubes overheated, ruptured, and were distorted as a result of scale which had formed on their inner

surfaces. The SEC attributed the scale to M-S' negligence in running the boilers with raw water. The SEC also stated that the improper priming of the boilers that occurred on the first trip was due to installation of incorrect baffles by M-S. M-S had undertaken to make the required repairs, and the SEC stated that this repair work was performed negligently, leading to further tube failures. [390 U.S. 414, 431] Part of the M-S claims was for unpaid charges for this repair work. M-S filed an answer on September 1 which admitted that when the Carib Queen was delivered it was suffering from "certain construction deficiencies," but denied any liability. It contended that its asserted lien claims were secured and that it had performed the repair work in a proper manner.

Although the SEC and the trustee had sought reference of the M-S claims to a special master for a hearing, no such hearing was ever held. Instead, the trustee subsequently moved for the summary allowance of the claims on the ground that there was only a "remote" possibility of materially reducing them by litigating the objections filed against them, and that such litigation would cause "unnecessary delay." 15 At the hearing during which the trustee presented his motion for allowing the M-S claims in full, no further explanation of this recommendation was provided. Counsel for the Committee protested that "this is not a report, this is a bare statement of conclusion." The trial judge himself recognized the importance of the question. He said:

> "I am concerned myself. I do know that whoever turned that vessel [the Carib Queen] loose with the [390 U.S. 414, 432] boilers in it, somebody made a bad mistake. I don't know who it was."

The matter was put over, and subsequently the Committee, supported by the Commission, the Department of Justice, and the Caplan mortgage group, filed objections. Notwithstanding these objections, and the doubts that he had earlier expressed, the trial judge confirmed the claims in full

as unsecured claims without further investigation of them. M-S, under the confirmed plan, is to receive 40% of the common stock of the reorganized company.

On July 11, 1962, the trial court filed its opinion and order approving both the internal and the cash plans of reorganization. The internal plan contained the provisions for "compromising" the Caplan mortgage and M-S claims. With regard to these sets of claims, the trial court stated that "it was apparent" that successful litigation of the claims TMT had against the holders of these claims "would take possibly years to conclude. . . ." The court continued:

> "It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders' Committee is too remote for serious consideration. . . . The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary [390 U.S. 414, 433] delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act."

This statement constitutes the only, and the last, 16 word that the trial court said on the merits of the compromises of the Caplan mortgage and M-S claims. Without reference to any of the objections that had been filed or to the substantial facts in the record tending to cast doubt upon the Caplan mortgage and M-S claims, the court accepted the bald conclusions of the trustee. This despite the fact that the trustee had once

concluded that the Caplan mortgage was null and void and that TMT had sizeable setoffs against its holders. This despite the fact that the trustee had once sought reference of the M-S claims to a special master for investigation. This despite the fact that the trustee had never placed on the record any of the facts of his subsequent investigation [390 U.S. 414, 434] and had never provided any explanation of why he had completely reversed his field on these claims. Although at this point in the proceedings it was clear that Anderson was to become president of the reorganized company, and though the trial court was understandably eager to wind up these protracted proceedings, there nowhere appears an adequate explanation for the trustee's cursory, conclusory recommendation of these "compromises," or the perfunctory, almost offhand, manner in which the court accepted that recommendation.

If the quoted statement of the trial court had been the result of an adequate and intelligent consideration of the merits of the claims, the difficulties of pursuing them, the potential harm to the debtor's estate caused by delay, and the fairness of the terms of settlement, then it would without question have been justifiable to approve the proposed compromises. It is essential, however, that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law. Here there is no explanation of how the strengths and weaknesses of the debtor's causes of action were evaluated or upon what grounds it was concluded that a settlement which allowed the creditor's claims in major part was "fair and equitable." Although we are told that the alternative to settlement was "extensive litigation at heavy expense" and "unnecessary delay," there is no evidence that this conclusion was based upon an educated estimate of the complexity, expense, and likely duration of

the litigation. Litigation and delay are always the alternative to settlement, and whether that alternative is worth pursuing necessarily depends upon a reasoned judgment as to the probable outcome of litigation. The complaint voiced by [390 U.S. 414, 435] counsel for the petitioner Committee to the trustee's report on the compromises, that "this is a bare statement of conclusion," seems equally applicable to the trial court's statement approving those compromises. In these circumstances it was error to affirm that aspect of the District Court's judgment approving inclusion of the proposed compromises in the internal plan of reorganization.

The Court of Appeals dealt with the District Court's approval of the compromises in five sentences. Noting that it was only the Committee and the SEC that were complaining, and remarking that it was unlikely that disallowance of the compromises would result in solvency, it felt that it was "significant that not a single creditor has ever complained of either compromise." 364 F.2d 936, 941. The question of insolvency will be returned to shortly. The argument that the compromises were properly approved because no creditors objected to them seems doubly dubious. When a bankruptcy court either fails adequately to investigate potential legal claims held by the debtor, or refuses to provide an adequate explanation of the basis for approving compromises, it is scarcely surprising that creditors fail to come forward with objections to the compromises. Moreover, this Court has held that a plan of reorganization which is unfair to some persons may not be approved by the court even though the vast majority of creditors have approved it. 17 [390 U.S. 414, 436]

The principal argument of the respondent supporting affirmance of the order approving the compromises is that "the district court had before it a thorough record concerning the facts and issues with respect to the compromises of these two claims." Respondent's Brief 38. With regard to the

Caplan mortgage claim, respondent points out that the facts and circumstances surrounding it were thoroughly documented in Anderson's report of his investigation. It is difficult to see how this strengthens respondent's position, however, for the report carefully documented the conclusion that the Caplan mortgage was a fraudulent transfer and that claims against the individual holders of the mortgage could be used as setoffs. The District Court's approval of the proposed compromise in the face of the facts and conclusions contained in the trustee's report is more difficult to understand than would be approval entered on a blank slate. Respondent also points out that the trial court had before it an answer to Anderson's report, the various objections filed to the mortgage claim, the claim itself, and the recommendations of the Creditors' Committee, the trustee and the trustee's counsel favoring the proposed settlement. The objections filed to the claim militate against the advisability of compromise, however, and the other matters referred to consist either of conclusory denials of liability or conclusory statements that the claims should be compromised. There is nothing in all these documents which could provide a sound basis for concluding that the claims against the mortgage and its holders were unmeritorious. 18 If the [390 U.S. 414, 437] trial court ever had before it facts which showed the claims against the Caplan mortgage and its holders to be without merit, or if the court ever discovered sound grounds for thinking that the delay incident to litigation or the unlikelihood of obtaining an adequate recovery, made compromise advisable, nothing in this record indicates it.

With regard to the M-S claims, respondent contends that the record contains "an abundance of pleadings and allegations" respecting them. Respondent's Brief 33. To make an informed and independent judgment, however, the court needs facts, not allegations. Respondent also contends that there were sufficient facts in the record, and provides a long

list of references to the places in the record where these facts can be found. If, indeed, the record contained adequate facts to support the decision of the trial court to approve the proposed compromises, a reviewing court would be properly reluctant to attack that action solely because the court failed adequately to set forth its reasons or the evidence on which they were based. The deficiency in this case, however, is not a merely formal one. The evidence referred to by respondent is analyzed at greater length in the margin. 19 [390 U.S. 414, 438] Here it is enough to say that to the extent that the record contains solid facts of the sort necessary for appraising the merits of the claims against M-S, virtually all of them point to the probable existence of valid [390 U.S. 414, 439] and valuable causes of action. Balancing these facts are nothing but bald assertions to the contrary and general conclusions for which foundations nowhere appear. Particularly noteworthy is the fact that, despite frequent [390 U.S. 414, 440] requests for an investigation, and notwithstanding the fact that the available evidence pointed to probably valid claims against M-S, no investigation of these matters was ever undertaken or ordered by the trial court. It is difficult to imagine how an informed and independent decision in favor of compromising the M-S claims in the full amount as unsecured claims could have been reached on the present state of the record.

The record before us leaves us completely uninformed as to whether the trial court ever evaluated the merits of the causes of actions held by the debtor, the prospects and problems of litigating those claims, or the fairness of the terms of compromise. More than this, the record is devoid of facts which would have permitted a reasoned [390 U.S. 414, 441] judgment that the claims of actions should be settled in this fashion. In reaching this conclusion, however, it is necessary to emphasize that we intimate no opinion as to the merits of the debtor's causes of action or as to the actual fairness of the proposed compromises. To the contrary, it is clear that the

present record is inadequate for assessing either, and that a remand is necessary to permit further hearings to be held. Only after further investigation can it be determined whether, and on what terms, these claims should be compromised.

III.

Under 174, 221 (2), of Chapter X, 52 Stat. 891, 897, 11 U.S.C. 574, 621 (2), a bankruptcy court is not to approve or confirm a plan of reorganization unless it is found to be "fair and equitable." This standard incorporates the absolute priority doctrine under which creditors and stockholders may participate only in accordance with their respective priorities, and "in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts . . . ." SEC v. United States Realty & Improvement Co., 310 U.S. 434, 452 (1940). Since participation by junior interests depends upon the claims of senior interests being fully satisfied, whether a plan of reorganization excluding junior interests is fair and equitable depends upon the value of the reorganized company. In the present case the District Court excluded the stockholders from participation because of its finding that the debtor was insolvent. Since the determination of insolvency was not made in accordance with the proper standards of valuation, neither the approval nor the confirmation of the plan can stand.

> The appropriate standard for valuing a company undergoing reorganization was set out at length in Consolidated [390 U.S. 414, 442] Rock Products Co. v. Du Bois, 312 U.S. 510, 526 (1941): "As Mr. Justice Holmes said in Galveston, H. & S. A. Ry. Co. v. Texas, 210 U.S. 217, 226, `the commercial value of property consists in the expectation of income from it.' . . . Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans

> involving productive properties. . . . The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable. . . . Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance." 20

In the present case the book value of the debtor's assets on May 31, 1962, was $1,887,185.77. Claims against the [390 U.S. 414, 443] debtor totaled $5,477,370.05. The actual fair value of the debtor's total assets was $2,238,387.62 and their net value was $1,978,481.73. Although these figures show that liabilities far exceeded assets, they are not of controlling importance. The District Court recognized that going-concern value, not book or appraisal value, must govern determination of the fairness of the plans of reorganization, and respondent concedes that the value of TMT's business depended "not on the inherent value of its assets but primarily on maintaining a high level of earnings." Brief for Respondent 42.

At the valuation hearings the trustee stated that his analysis of the financial structure and business of the debtor resulted in a going-concern value of $2,031,403.72. A valuation expert presented by the trustee estimated the going-concern value at between $1,607,692 and $1,800,000. He arrived at his conclusion by multiplying his estimate of the future earnings of the company by 7.7, a figure based on the

assumption that earnings would be 13% of value. The valuation expert presented by the Committee concluded that estimated future earnings after taxes would be $327,500, and multiplying this by a price-earnings ratio of 13.8, arrived at the conclusion that TMT had a value of $4,519,500. The trial judge took an intermediate position. By projecting current earnings of the debtor for the first five months of 1962 over the remainder of the year, he concluded that pre-tax earnings would be $568,000. Reduced by estimated income taxes and capitalized at 10%, this yielded a going-concern value of $2,780,000. Since this figure fell well below the $5,477,370.05 of outstanding claims, he concluded that the debtor was insolvent. On this basis the plan was approved and confirmed.

When the Court of Appeals remanded to the District Court for determination of the feasibility of the reorganization plan after giving full priority to the Government's [390 U.S. 414, 444] claims, the District Court concluded that TMT was "more insolvent now than it was in 1962," for earnings had declined from the high point of 1962, and the Court's initial determination had been based on the projected earnings for that year. The decline in earnings had occurred even though the volume of business had grown substantially, for increased competition from large steamship lines serving Puerto Rico had forced TMT to lower its rates and thus its margin of profit. The District Court reaffirmed its finding of insolvency. On appeal, the Court of Appeals stated that it did not have to determine whether or not the District Court's finding of insolvency was accurately computed, but merely whether it was "clearly erroneous." On this basis the conclusion of insolvency was affirmed.

In a complex case of this nature it is not the province of this Court to attempt to retry issues of fact which have been fully litigated below. Indeed, as the Court of Appeals stated, much weight must be given to the long familiarity of the District

Judge with the debtor and to his evaluation of the witnesses who testified in his presence. In the face of conflicting expert testimony as to the going-concern value of the debtor based on current earnings, the trial judge adopted a position in between. We are not disposed to dispute the conclusion of the Court of Appeals that this determination by the trial judge was not "clearly erroneous." However, examination of the facts of this case demonstrates that the District Court did not have before it all of the evidence and testimony relating to the future problems and prospects of the company which were necessary to assess its value as a going concern. Indeed, the trial judge steadfastly refused to consider the value of the company once it was out of the reorganization proceedings. In this there was error, and it was an error which infected the conclusions of the trial court that the debtor was insolvent. [390 U.S. 414, 445] Evaluations of evidence reached by the accurate application of erroneous legal standards are erroneous evaluations.

TMT plays a minor but unique role in carrying goods between Puerto Rico and the United States. This domestic offshore trade is highly competitive and generally unprofitable. The high density, high volume, and high operating-cost trade with Puerto Rico flows in and through the North Atlantic ports. TMT, operating in a triangle between San Juan, Miami, and Jacksonville, is confined to the low density, low investment South Atlantic trade. TMT carries only about 2% of the total trade with Puerto Rico, and the dominant carrier in the market is in direct competition with it in its home port of Jacksonville. When TMT entered the market with its novel idea of carrying roll-on and roll-off freight in towed vessels, the market was ripe for an innovation of this sort. However, the ills which plagued its early years threw TMT into bankruptcy in 1957. Prevented by the exigencies of the bankruptcy proceeding from capitalizing on the novel idea it had introduced, TMT has watched the development of container shipping, which has

taken over a large share of the United States-Puerto Rico trade for which it might otherwise have hoped to compete. Nonetheless, TMT remains the only roll-on and roll-off carrier in the trade, and it has seen its own business rise 10% to 20% a year due to the increased frequency of direct interchange with piggyback rail transport. Despite the inability of TMT to capitalize on its novel idea, it has remained in a strong competitive position. Trade with Puerto Rico has increased steadily and rapidly, and TMT's business has grown commensurately. Despite a destructive rate war which markedly lowered the revenues earned per voyage, TMT increased its revenue from $3,801,000 in 1962, when the first insolvency hearing [390 U.S. 414, 446] was held, to $4,779,000 in 1964, the latest year in the record. Between the 1962 and the 1965 hearings the fleet of vessels was increased from three to five and the number of truck trailers from 350 to 670. Moreover, in the 1965 hearing the business manager could report that after it paid the forthcoming installment for the reconversion of one of its vessels, the company would have no further significant outstanding indebtedness. TMT has continued to be the only unsubsidized carrier in the South Atlantic trade, the only one that makes money. Despite the increase in volume and revenue, however, the rate war and other factors such as rising costs caused net earnings to drop after 1962, and they have not yet regained the level established that year. TMT's tax-loss carry-over has expired, with the result that earnings are now substantially reduced by federal taxes. The general trade picture between Puerto Rico and the United States is in flux, and the rates applicable to the trade are undergoing continuing revision and investigation. The vessels TMT uses are old and in need of replacement. The supply of LST's has nearly dried up, and it seems to be understood that the replacement vessels will have to be built from scratch.

In short, TMT would seem to be a company which has established, preserved, and increased its share of a highly

competitive market despite intense competition and major internal crises. It operates in a market undergoing substantial change and is itself faced with the imminent need to re-equip its fleet. In these circumstances, an adequate notion of the going-concern value of TMT could be obtained only by looking to the future as well as the past. Against this background we must examine the information which the trial court had before it for assessing the future prospects of TMT. The basic source for information on these matters was, of course, the trustee and his business manager. A short summary of [390 U.S. 414, 447] the highlights of their testimony as it related to the future prospects of TMT will demonstrate the inadequacy of the information provided the trial judge for making this crucial determination.

At the first insolvency hearing the business manager attempted to estimate the earnings of the company for the next four years, but he made his projections solely on the business as it then was. Although TMT had attained the maximum number of voyages possible with the fleet it then had, the business manager had not looked into the possibility of chartering additional vessels. The trustee testified that several vessels would have to be replaced in the next two years, but admitted that he was unable to predict what such vessels would cost. When the trustee was asked if there was foreseeable room for expansion of TMT's business, the Court agreed with an objection that this was beyond the scope of the valuation hearing. The trustee's expert on valuation gave his opinion as to going-concern value solely on the basis of the trustee's projection of earnings, which in turn was based wholly on past earnings. Those earnings figures had been drawn up some time prior to the hearing, and it was conceded that they might have come out differently if the projection had been made at the time of the valuation hearing. When asked if he would attempt to predict whether the company would be able to pay dividends once it was out of reorganization, or whether large capital investments

would soak up all earnings, the trustee's expert replied that he had not been asked to consider that question and did not think it legitimate. Although he agreed that reasonably foreseeable changes and improvements should be taken into account in valuing the company, he stated that he had been given no information on which to make such predictions. [390 U.S. 414, 448]

At the second hearing on the value of the company, the business manager admitted that he had made no new projection of future expenses, revenue, or income, even though three years had passed and the business outlook of the firm was markedly different. Although TMT's fleet had grown in the interim from three to five vessels, and there was an imminent need for replacement of the older ships, the business manager was unable to predict the likely impact on earnings of the acquisition of newer vessels. He stated that the new vessels would be towed craft that loaded from the stern, and that they were apt to cost between $1,250,000 and $1,500,000 each. However, though some studies and inquiries had been conducted, there were no final or definite plans or drawings for the new ships. Although new, better, and more efficient vessels were needed soon to improve the company's competitive situation, in the present state of planning it would be two years after the company was out of reorganization before new vessels would be obtained. At the second hearing, as at the first, the business manager could give no estimate of what portion of the administration costs of running TMT was due to the reorganization proceedings. Although he thought that trade between the United States and Puerto Rico was increasing, he did not know how much or in what ways. Though he thought that TMT's share of the Puerto Rican trade was remaining comparatively constant, he did not know for certain. He also did not know what portion of TMT's present volume of business was attributable to direct piggyback interchange.

The data which the trustee and his business manager had submitted with regard to past income and expenses undoubtedly provided a clear picture of what the company had been experiencing in the past. Given, however, that it was a relatively small and young company [390 U.S. 414, 449] much in need of internal rebuilding and operating in a market undergoing important economic and technological change, it was essential that some clear idea be gained of its future prospects. It seems perfectly obvious that the information introduced at the two hearings was inadequate for gaining even a rough idea of TMT's future prospects.

The fundamental reason that there was insufficient evidence concerning the future prospects of TMT was that the trial court showed itself unalterably hostile to inquiries directed to TMT's future. During the first hearing the following interchange took place when the court cut off a question aimed at determining whether the volume of TMT's southbound traffic could be increased during the off-peak season:

> "Q. But if this enterprise were out from under the proceedings, would it?
> "The COURT. Well, we are dealing with an organization that is in. Let's assume that it will stay right there and try to get the value. It is not going to get out until it is reorganized.
> "Mr. MASON. We are trying to get the value when reorganized.
> "The COURT. That is of no importance to me. Let's value it as it now exists to determine what should be done in these proceedings."

At a later time, when counsel again sought to establish that the proper way to value the company was to try to determine foreseeable factors which would affect future earnings, the court pre-empted the answer by remarking, "Mr. Witness, we do not want possibilities." Still later, the judge said:

> "All these projections into the future are not going to bother the Court. These creditors have waited [390 U.S. 414, 450] too long to get their money. We have had this thing for years and years. I imagine most of them long since have gone to the poorhouse or given up."

One can easily sympathize with the desire of a court to terminate bankruptcy reorganization proceedings, for they are frequently protracted. The need for expedition, however, is not a justification for abandoning proper standards. It is also easy to share the court's concern that creditors receive their money as promptly as possible. However, the right of stockholders to participate at all hung on the result of the valuation proceedings; sedulously eliminating all inquiry into the future may, in this context, have caused the rights of the stockholders to have been relinquished by default.

Although three years elapsed before the next hearing, the judge displayed the same unwillingness to permit inquiry into the future prospects of TMT. When counsel for the SECtried to open up the subject, the following dialogue occurred:

> "Mr. GONSEN. We have no startling figures, but a series of questions relating to the possible future prospects of this company.
> "The COURT. There is no possible future prospects other than what is going on. It is possible it will become the greatest fleet in the world and it is possible to go bankrupt in a few months. As a matter of fact, if the competition had succeeded in their plans, you would have no problem here, they would have been sold.
> "Mr. GONSEN. Do I understand Your Honor does not desire me to examine as to evaluation?
> "The COURT. You do."

Perhaps the proper reading of the reluctance of the judge to go into future prospects at the second hearing was that in his view the issue of insolvency was no longer in [390 U.S. 414, 451] the case. The Court of Appeals had ruled on the question of whether the trustee could be the president of the reorganized company and whether the Government's nontax claims should be allowed in full without discussing the other issues. In the trial judge's view, the Court of Appeals' failure to speak on other issues constituted affirmance. On the appeal from the second hearing, however, the Court of Appeals took pains to point out the error in this conclusion. The result of the trial court's ruling was to exclude from the hearing the general issue of insolvency and to limit the hearing to the question of whether developments between the first and second hearings had rendered the plan unfeasible in light of the necessity of giving full priority to the Government's nontax claims. In such circumstances it might be expected that the Court of Appeals would have examined the record to see if the facts supported the conclusion which the trial judge had felt foreclosed from having to make again, but which was in fact still in the case. Instead, however, the Court of Appeals merely quoted at length from the trial court's conclusions that the plan was feasible and stated that the ruling that the company was still insolvent was not clearly erroneous.

At the close of the second hearing the SEC and the Committee argued vigorously that the issue of valuation was still open and that future prospects should have been considered by the judge. Although its view of the effect of the appeal from the first hearing did not require it to do so, the court addressed itself to the merits of this contention in its opinion and order approving the amended plan of reorganization:

> "The SEC and the Stockholders Committee insist, as they did during the valuation hearings in 1962, that

> the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial [390 U.S. 414, 452] changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee [n]or the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable."

This was not a correct statement or application of the law. This Court has declared that in every case it is incumbent upon the reorganization court to consider "all facts relevant to future earning capacity . . . including . . . all circumstances which indicate whether or not [the past earnings] record is a reliable criterion of future performance." Consolidated Rock Products Co. v. Du Bois, supra. If it is shown that the record of past earnings is not a reliable criterion of future performance, the court must form an estimate of future performance by inquiring into all foreseeable factors which may affect future prospects. In forming this estimate, "mathematical certitude" is neither expected nor required.

In this case we have a company engaged in a hotly competitive market, a market experiencing a severe rate war which would probably alter the relative standings of the competitors. The market as a whole was witnessing substantial technological change, and TMT itself was one of the prime innovators. TMT's principal market, Puerto Rico, was undergoing considerable expansion. It was shown without contradiction that TMT needed to replace its present fleet with new and different ships. It should have been clear to the trial court that the circumstances brought out at the two hearings showed that the past earnings record was not a reliable criterion of future performance, and that sound

evaluation of the [390 U.S. 414, 453] company as a going concern required examination of the future prospects of the company. The court was not dealing with an established company in a static market, nor was it being asked to value the company's future prospects by hypothesizing unforeseeable changes in operations or market structure. It was evident that certain specific and predictable alterations would have to be made in the equipment and operations of the company in order to meet foreseeable alterations in the market. The trial court shut its eyes to these important developments and in so doing ignored a cardinal principle of proper evaluation.

IV.

Because only past earnings were relied upon in this case in determining the value of the debtor as a going concern, we reverse and remand to the Court of Appeals with directions to remand to the District Court to hold new hearings on valuation. Without in any way prejudging the issue, it is possible that when the compromises discussed in Part II of this opinion are reconsidered, and when the company is properly valued by taking into account its future prospects, the company will be found not to be insolvent. Such a finding would permit stockholders to participate. There is, therefore, no point in considering at this juncture the question presented by the petitioner concerning the stockholders' claims under the federal securities laws. Since the Committee will, of course, be entitled to participate in the new hearings on valuation and insolvency, the order of the District Court discharging it is vacated. So doing, however, reflects no opinion on the merits of the arguments presented in this Court by petitioner as to why it should not have been discharged. Finally, there is no necessity to determine whether it was improper to contemplate making the trustee president of the reorganized company. A great deal of time has passed since that was deemed [390 U.S.

414, 454] an advisable plan, and intervening circumstances may well have altered the views of the participants. Since new hearings on valuation and insolvency will further protract these proceedings, it seems advisable to put that question aside.

For the reasons stated in this opinion, we reverse and remand to the Court of Appeals for further proceedings consistent with this opinion.

Reversed and remanded.

MR. JUSTICE MARSHALL took no part in the consideration or decision of this case.

Footnotes

[Footnote 1] This case has been in the federal courts for over 10 years. The earlier reported decisions consist of the following: Caplan v. Anderson, 256 F.2d 416 (C. A. 5th Cir. 1958); Caplan v. Anderson, 259 F.2d 283 (C. A. 5th Cir. 1958); TMT Trailer Ferry, Inc. v. Anderson, 292 F.2d 455 (C. A. 5th Cir. 1961), cert. denied sub nom. Shaffer v. Anderson, 368 U.S. 956 (1962); United States v. Anderson, 334 F.2d 111 (C. A. 5th Cir.), cert. denied, 379 U.S. 879 (1964); In re TMT Trailer Ferry, Inc., 334 F.2d 118 (C. A. 5th Cir. 1964).

[Footnote 2] The order of the District Court discharging the petitioner Committee was later modified to permit the Committee to prosecute appeals from that decision.

[Footnote 3] The SEC participated as a party in both the District Court and the Court of Appeals, and has appeared as an unnamed respondent before this Court. See 52 Stat. 890, 894, 11 U.S.C. 572, [390 U.S. 414, 421] 608. This Court requested the Government to express its views at the petition stage, 386 U.S. 901 (1967). For the most part the SEC has taken positions consistent with those of the petitioner Committee.

[Footnote 4] TMT Trailer Ferry, Inc. v. Anderson, 292 F.2d 455 (C. A. 5th Cir. 1961), cert. denied sub nom. Shaffer v. Anderson, 368 U.S. 956 (1962). The Committee's earlier appeal attacking the confirmation of the 1959 plan, which had been consolidated with this appeal by the Caplan

mortgage group, was mooted by the order of the trial court vacating the confirmation.

[Footnote 5] In re TMT Trailer Ferry, Inc., 334 F.2d 118 (C. A. 5th Cir. 1964).

[Footnote 6] United States v. Anderson, 334 F.2d 111 (C. A. 5th Cir.), cert. denied, 379 U.S. 879 (1964).

[Footnote 7] Protective Committee v. Anderson, 364 F.2d 936, 939 (C. A. 5th Cir. 1966).

[Footnote 8] The other issues, briefed and argued at length, are succinctly stated in the brief filed by the SEC: "1. Whether under Chapter X of the Bankruptcy Act, which provides for a disinterested trustee as the focal point of the reorganization, the trustee is precluded from assuming the presidency of the reorganized company; and whether a plan that contemplates that result may be confirmed. . . . . "4. Whether the courts below erred in refusing to consider the merits of the stockholders' claims based on asserted violations of the securities laws. "5. Whether the district court erred in discharging the Stockholders' Committee before the reorganization proceedings were completed, on the basis of its finding that the debtor was insolvent." Brief for SEC 2, 3.

[Footnote 9] The interest is to be treated as an unsecured claim payable in common stock in the reorganized company. The plan confirmed by the court was later amended to provide that the holders of the Caplan mortgage would receive $250,000 in cash at the date of consummation of the reorganization plan, rather than $280,500 over five years. [Footnote 10] Since the rest of the voting stock will go to the other numerous and scattered general creditors, petitioner argues that M-S' 40% ownership will give it initial working control of the reorganized company. Petitioner's Brief 28, 29.

[Footnote 11] Accordingly, to pay holders of the Caplan mortgage $280,500 in cash, even though only the amount they paid for the mortgage, [390 U.S. 414, 427] would be a substantial preferment of them when the reorganization plan allows general unsecured creditors only a pro rata portion of some 1,300,000 shares of new common stock in the reorganized company.

[Footnote 12] 17 CFR 240.10b-5; promulgated by the SEC pursuant to 10 (b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j.

[Footnote 13] Such subordination would effectively eliminate their claims if TMT were as insolvent as the court subsequently found.

[Footnote 14] These terms were later modified, as indicated in n. 9, supra.

[Footnote 15] The trustee reached this conclusion after an investigation described by him in full as follows: "[T]he trustee, with the assistance of attorneys in the office of his counsel, investigated the facts alleged in the specifications of objections filed by the SEC and in the answer of Merrill-Stevens. This investigation consisted of an examination of numerous documents assembled by the SEC during its investigation, together with copies of statements made by individuals which had been obtained during the investigation. Also examined were numerous documents and statements furnished by Merrill-Stevens in support of its answer to the specifications of objections by the SEC." The trustee did not set out any findings of fact which he arrived at in the course of this "investigation," and provided no explanation of the reasoning which had led to his "considered opinion" that the M-S claims should be allowed in full.

[Footnote 16] In December 1964, after the case had been remanded for the second time by the Court of Appeals, the Committee sought an order for production of documents relating to the Carib Queen, alleging they would show that TMT had a cause of action against M-S and the Caplan group. The Committee said these parties had acted "in collusion with members of the debtor's old management and control group to defraud the Maritime Administration and the debtor by misrepresentation of the reconversion contract price and by premature release of the vessel without proper compliance with the requirements of the reconversion contract. The same documents also bear on the propriety of the compromises . . . ." At the hearing held on this motion it appeared that these documents were held by the Maritime Administration, which had no objection to turning them over but wished the court to issue a formal order so that all parties could have access to them. The court denied the motion, saying "there is nothing in the motion that shows that these documents are material to any issue before this Court." When reconfirming the plan after the second remand, the court added nothing to the explanation quoted in the text, for it erroneously concluded that

approval of the settlement had already been affirmed by the Court of Appeals.

[Footnote 17] Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939). "[W]here a plan is not fair and equitable as a matter of law it cannot be approved by the court . . . . Congress has was told that the trustee and his lawyers had looked at the relevant papers, that the possibility of recovery was remote, and that litigation would cause unnecessary delay. No facts or arguments to support these conclusions were presented. Counsel for the Committee objected that this was not a report but a bare statement of conclusion. The court indicated that someone had been at fault over the boiler breakdown. (9) The Committee's specification of objections to the M-S claims. This 35-page report, 22 pages of which are devoted to the Carib Queen contract, was the result of an independent examination conducted by the Committee into the M-S claims. The Committee charged M-S with faulty design, construction, and repair of the Carib Queen. With regard to two other ships on which M-S worked for TMT, the Committee charged M-S with responsibility for the swamping of one on its trial trip, and with failing to get Coast Guard approval of the other. The Committee also claimed that the maritime liens asserted by M-S had been reduced by payments on account, and that the original TMT management, M-S, and Abrams and Shaffer had worked together in a collusive relationship designed to make large profits by selling cheaply purchased stock to the public at inflated values. Some idea of the factual particularity of the Committee's objections is provided by the abbreviated subheadings of their charges against M-S in connection with the Carib Queen. The Committee stated that TMT had causes of action growing out of the fact that M-S (a) failed to secure proper certificates of work completion affecting the classification and rating of the vessel, (b) failed to fit riveted crack-arresting seams, (c) failed to produce a vessel of 3,050 shaft-horsepower per shaft, propeller speed of 216 r. p. m., and speed in service of 15 1/2 knots, (d) failed to produce a ship of high enough classification and rating, (e) failed to clean the boilers chemically, (f) wrongly assumed that the boilers had been properly protected up to the time of conversion, (g) failed to use distilled water in its preliminary running of the boilers, (h) improperly connected the [390 U.S. 414, 440] piping, (i) installed incorrect baffle plates, (j) failed to clean the boilers adequately when performing the repair work, (k) failed to install the ventilating system properly, (l) installed an inadequate and inappropriate evaporator, (m) failed to put the feed water regulator and the feed pump governor into proper working order, (n) failed to install a boiler compound injector pump, (o) failed to provide equipment for coping with the excessive oxygen content of the water in the system, and (p) was responsible for

deficiencies in the electrical system. In addition, the Committee stated that M-S was improperly claiming for repair work done under its guarantee obligation, and that M-S had included claims for work done as to which no amount had ever been agreed upon. (10) The statement by the SEC supporting the Committee's specification of objections. The SEC, while not necessarily agreeing with all the allegations and contentions of the Committee, felt that the Committee had demonstrated that M-S should be required to prove its claims at a judicial hearing. In addition to these matters of record, respondent refers to several matters not in the record, which are said to support the propriety of accepting the compromises. Matters not in the record and not properly the subject of judicial notice cannot form the basis of judicial confirmation of a plan of reorganization. They are equally unavailing on review.

[Footnote 20] Further on the subject of valuation, see 2 J. Bonbright, Valuation of Property 880-881 (1937); 6A Collier, Bankruptcy □□ 10.13 and 11.05 (14th ed. 1965); H. Guthmann & H. Dougall, Corporate Financial Policy 656-657 (4th ed. 1962). See also Frank, Epithetical Jurisprudence and the Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act, 18 N. Y. U. L. Q. Rev. 317, 342, n. 68 (1941): "Value is the present worth of future anticipated earnings. It is not directly dependent on past earnings; these latter are important only as a guide in the prediction of future earnings."

MR. JUSTICE HARLAN, whom MR. JUSTICE STEWART and MR. JUSTICE FORTAS join, dissenting.

In my opinion, the only question which could be thought even remotely to justify the presence of this case in this Court is whether the trustee, by virtue of his office, was as a matter of law disqualified from being selected as president of the reorganized company. The Court, however, does not decide that question. The review of the massive record in these reorganization proceedings, which have been in the courts for over 10 years and on six occasions before the Court of Appeals at various stages, is not in my view an appropriate task for this Court. Believing that this decision bodes little but further delay in bringing this protracted proceeding to a conclusion, I feel justified in voting to dismiss the writ as improvidently granted, despite the fact that the case was brought here on an unrestricted writ. Since

the Court does not reach the "disqualification" issue, I consider it inappropriate for me, as an individual Justice, to express my own views upon it. [390 U.S. 414, 455]